

No. 16702

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United States  
Court of Appeals  
for the Ninth Circuit

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SCHALK CHEMICAL COMPANY, a Corpora-  
tion; GERALD I. FARMAN, HAZEL I.  
FARMAN, JOHN CARVER BAKER and  
PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Transcript of Record

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Petition to Review a Decision of the Tax Court  
of the United States

FILE

APR 13 1960

PHILLIPS & VAN ORDEN CO.



No. 16702

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GERALD I. FARMAN, HAZEL I. FARMAN,  
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

DONALD KEITH HALL,  
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Los Angeles 14, Calif.,  
For Petitioners.

CHARLES K. RICE,  
Asst. Atty. General,  
Tax Div. Dept. of Justice,  
Washington 25, D.C.,  
For Respondent.



The Tax Court of the United States

Docket No. 63853

SCHALK CHEMICAL COMPANY, a California  
Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

1956

Aug. 20—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 22—Copy of petition served on General Counsel.

Aug. 20—Request for Circuit hearing in Los Angeles, Calif., filed by Petr. 8/21/56 Granted. Served 8/22/56.

Oct. 2—Answer filed by resp. Served 10/4/56.

1958

Mar. 13—Notice of trial at L. A., Calif., June 23, 1958.

July 16-22—Trial before Judge Raum. Resp. oral motion to consolidate (63853, 55, 62) Granted. Stip. of Facts and Stip. of Facts-B, Resp. Trial Memo., filed at trial. Appearance of Donald K. Hall, filed at trial. Served subpoena of Horace O. Smith, Jr., and Henry O. Wackerbarth. Petr's Brief due Sept. 5, 1958. Reply Brief due Oct. 6, 1958. Answer to Reply due Oct. 27, 1958.

1958

- July 28—Motion by Petr. for a 30 day extension of time to file opening brief. Granted 8/6/58.
- Aug. 4—Transcript of Proceedings 7/16, 7/17, 7/18, 7/21, 7/22/58 filed. (5 Vols.).
- Oct. 6—Petr's Brief filed. Served 10/7/58.
- Nov. 5—Motion by Resp. for extension of time to Dec. 22, 1958, to file brief in answer. 11/6/58, Granted. Served 11/7/58.
- Dec. 22—Brief for Resp. filed. Served 12/29/58.

1959

- Jan. 7—Motion by petr. for extension of time to Feb. 2, 1959, to file reply brief. 1/9/59, Granted.
- Feb. 2—Reply Brief filed by Petr. Served 2/5/59.
- July 9—Findings of Fact and Opinion filed, Judge Raum. Decision will be entered for the Resp. Served 7/9/59.
- July 21—Decision entered, Judge Raum. Served 7/22/59.
- Oct. 19—Petition for Review by U.S.C.A., 9th Cir., filed by petr.
- Oct. 19—Proof of service of pet. for rev. filed.
- Oct. '26—Designation of Contents of Record with proof of service attached filed by petr.
- Oct. 29—Motion by resp. for permission to substitute photostatic copies of certain orig. exs. 10/30/59, Granted. Served 11/3/59.

[Title of Tax Court.]

Docket No. 63855

GERALD I. FARMAN and HAZEL I. FARMAN,  
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

[Docket Entries in the above title of cause and No. are identical to those set out in full in Docket No. 63853.]

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[Title of Tax Court.]

Docket No. 63862

JOHN CARVER BAKER and PATRICIA  
BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

[Docket Entries in the above title of cause and No. are identical to those set out in full in Docket No. 63853.]

[Title of Tax Court and Cause.]

Docket No. 63853

## PETITION

Petitioner Schalk Chemical Company, a California corporation, respectfully petitions the Tax Court of the United States for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated May 23, 1956, and in support of its petition alleges:

### I.

Petitioner is a corporation organized and existing under the laws of the State of California, having its principal place of business at 351 East Second Street, Los Angeles 12, California. Petitioner's income tax return for the year 1950, with which this proceeding is concerned, was filed with the Collector of Internal Revenue for the Sixth District of Los Angeles, California.

### II.

The notice of deficiency dated May 23, 1956 (copy of which is attached and marked Exhibit "A"), was mailed to Petitioner on or after the date of the notice.

### III.

The Commissioner has determined a deficiency in income tax for the year 1950 in the amount of \$15,-087.22, all of which is in controversy.



IV.

The determination of tax liability set forth in the notice of deficiency is based on these errors:

(1) The Commissioner erred in disallowing the deduction of \$45,000.00 claimed as a business expense on Petitioner's return for the year 1950.

(2) The Commissioner erred in disallowing the deduction of \$3,697.92 claimed as interest expense on Petitioner's return for the year 1950.

V.

The facts upon which Petitioner relies in seeking a redetermination of the alleged deficiency are:

Preliminary Facts

(1) Petitioner filed a timely Federal income tax return for the year 1950, reporting a net loss of \$692.79.

(2) Petitioner has issued and outstanding 100,000 shares of its capital stock, 16,666 of which since 1951 have been held as treasury shares.

The Trust

(3) From 1930 to 1950 the 100,000 outstanding shares of Petitioner were the principal asset of an express trust created on December 29, 1930. At all times material to this case prior to termination of the trust the beneficial interests of Petitioner's present shareholders totaled five-sixths and Horace O. Smith, Jr., held the remaining one-sixth beneficial interest in the trust.

(4) The declaration of trust designated alternate "Supervisors," each of whom while in office was to have the equivalent of plenary power of management over the trust and Petitioner, including the power and right to appoint a majority of the Board of Directors of Petitioner and the power and right to vote all the shares of Petitioner, all of which were to be issued in the name of the trustee bank, except shares needed to qualify the directors.

(5) In 1942 Horace O. Smith, Jr., then 28 years of age, succeeded to the office of Supervisor of the trust, being one of the designated alternates, and by virtue of that office thereafter and until 1948 dominated and controlled the Board of Directors of Petitioner and in consequence held domination and control of Petitioner.

(6) As a result of the domination and control of Petitioner by Horace O. Smith, Jr., his lack of experience and judgment and his unflinching refusal to heed the pleas of a majority of the beneficiaries of the trust, the business and reputation of Petitioner were adversely affected to an extremely serious and near catastrophic extent.

(7) From 1944 to 1948 the other beneficiaries of the trust employed every available means, including removal litigation, to neutralize the control of Petitioner by Horace O. Smith, Jr., for the benefit of Petitioner.

#### Settlement

(8) The lawsuit to remove Horace O. Smith, Jr., and the dispute between the beneficiaries concern-

ing the policies and management of Petitioner were settled by an agreement dated January 15, 1948, under which Horace O. Smith, Jr., resigned as Supervisor of the trust and as an officer and director of Petitioner and agreed to secure the resignations of the officers and directors of Petitioner whom he had caused to be elected and dominated.

(9) Without deviation, Horace O. Smith, Jr., insisted that the settlement agreement be with the other beneficiaries of the trust and not with Petitioner and that it include the purchase of his one-sixth beneficial interest for a price of \$45,000.00, of which \$25,000.00 was to be paid to him immediately and \$20,000.00 on termination of the trust in 1950.

(10) The sole motivation of the other beneficiaries in entering into the agreement in 1948 with Horace O. Smith, Jr., was their desire to relieve Petitioner of the onerous and extremely detrimental effect of his domination and control of Petitioner.

(11) Pursuant to the agreement, but for the use and benefit of Petitioner, the other beneficiaries paid \$25,000.00 to Horace O. Smith, Jr., in 1948 and his resignation and the resignations of his nominees were effectuated.

#### Assignment Agreement

(12) On December 29, 1950, under an authorizing resolution of its Board of Directors adopted on December 15, 1950, Petitioner entered into an assignment agreement with the other beneficiaries of

the trust under which their rights under the 1948 agreement were assigned to Petitioner and Petitioner assumed the obligation to pay \$20,000.00 to Horace O. Smith, Jr., and agreed to reimburse with interest the \$25,000.00 which had been paid to Horace O. Smith, Jr., in 1948 on behalf and for the use and benefit of Petitioner.

### Deductions Claimed

(13) In its return for 1950 Petitioner deducted as a business expense the \$45,000.00 which it agreed to pay pursuant to the assignment agreement.

(14) In its return for 1950 petitioner also deducted as interest expense \$3,697.92 representing interest on the \$25,000.00 expended on its behalf and for its protection in 1948 and for which Petitioner in 1950 agreed to make reimbursement.

Wherefore, Petitioner requests that the Honorable Tax Court hear this proceeding and determine:

(1) That the expense of \$45,000.00 claimed by Petitioner in 1950 as an ordinary and necessary business expense incurred for the protection of Petitioner's business was an allowable deduction;

(2) That the interest expense of \$3,697.92 claimed by Petitioner in 1950 was an allowable deduction; and

(3) That there is no deficiency due from Petitioner for the year 1950.

Respectfully submitted,

/s/ HUGH W. DARLING,  
Counsel for Petitioner.

Duly verified.

Received and filed August 20, 1956, T.C.U.S.

Served August 22, 1956.

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[Title of Tax Court and Cause.]

Docket No. 63853

ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

Denies the allegations of error contained in paragraph IV of the petition.

V.

(1) through (5). With regard to the facts upon which petitioner relies in seeking a redetermination of the alleged deficiency, admits the allegations contained in subparagraphs (1) through (5) of paragraph V of the petition.

(6) and (7) Denies the allegations contained in subparagraphs (6) and (7) of paragraph V of the petition.

(8) Admits the allegations contained in subparagraph (8) of paragraph V of the petition.

(9) through (12) Denies the allegations contained in subparagraphs (9) through (12) of paragraph V of the petition.

(13) Admits the allegations contained in subparagraph (13) of paragraph V of the petition.

(14) Denies the allegations contained in subparagraph (14) of paragraph V of the petition.

## VI.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ JOHN POTTS BARNES,

R.E.M.

Chief Counsel, Internal  
Revenue Service.

Of Counsel:

T. M. MATHER,

Acting Regional Counsel;

E. C. CROUTER,

Assistant Regional Counsel;

R. E. MAIDEN, JR.,

Special Assistant to the Regional Counsel;

JOSEPH G. WHITE, JR.,

Attorney, Internal Revenue Service,

1135 Subway Terminal Bldg.,

417 So. Hill Street,

Los Angeles 13, California.

Filed October 2, 1956, T.C.U.S.

Entered October 4, 1956.

Served October 4, 1956.

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[Title of Tax Court and Cause.]

Docket No. 63855

### PETITION

Petitioners Gerald I. Farman and Hazel I. Farman respectfully petition the Tax Court of the United States for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated May 23, 1956, and in support of their petition allege:

#### I.

Petitioners are husband and wife and reside at 205 West Orange Grove Avenue, Sierra Madre, California. Their joint income tax return for the year 1951, with which this proceeding is concerned, was filed with the Collector of Internal Revenue for

the Sixth District of California, Los Angeles, California.

## II.

The notice of deficiency dated May 23, 1956 (copy of which is attached and marked Exhibit "A"), was mailed to Petitioners on or after the date of the notice.

## III.

The Commissioner has determined a deficiency in income tax for the year 1951 in the amount of \$11,589.98, all of which is in controversy.

## IV.

The determination of tax liability set forth in the notice of deficiency is based on these errors:

(1) The Commissioner erred in determining that Petitioners received dividends in the amount of \$27,000.00 from Schalk Chemical Company in the year 1951.

(2) The Commissioner erred in determining that Petitioners omitted from their gross income for the year 1951 an amount in excess of 25% of the gross income reported by them.

## V.

The facts upon which Petitioners rely in seeking a redetermination of the alleged deficiency are:

### Preliminary Facts

(1) Petitioners filed a timely joint Federal income tax return for the year 1951, reporting a net income before exemptions of \$14,341.63.



(2) Schalk Chemical Company is a corporation organized in 1903 and existing under the laws of the State of California, having its principal place of business at 351 East Second Street, Los Angeles, California, and has issued and outstanding 100,000 shares of its capital stock, 16,666 of which since 1951 have been held as treasury shares.

(3) Petitioner Hazel I. Farman in 1951 owned and now owns 50,000 shares of the capital stock of Schalk Chemical Company.

#### The Trust

(4) From 1930 to 1950 the outstanding shares of Schalk Chemical Company were the principal asset of an express trust created on December 29, 1930. At all times material to this case prior to the termination of the trust Petitioner Hazel I. Farman had a one-half beneficial interest and her son, Horace O. Smith, Jr., a one-sixth beneficial interest in the trust.

(5) The declaration of trust designated alternate "Supervisors," each of whom while in office was to have the equivalent of plenary power of management over the trust and Schalk Chemical Company, including the power and right to appoint a majority of the Board of Directors of Schalk Chemical Company and the power and right to vote all the shares of Schalk Chemical Company, all of which were to be issued in the name of the trustee bank, except shares needed to qualify the directors.

(6) In 1942 Horace O. Smith, Jr., then 28 years of age, succeeded to the office of Supervisor of the trust, being one of the designated alternates, and by virtue of that office thereafter and until 1948 dominated and controlled the Board of Directors of Schalk Chemical Company and in consequence held domination and control of Schalk Chemical Company.

(7) As a result of the domination and control of Schalk Chemical Company by Horace O. Smith, Jr., his lack of experience and judgment and his unflinching refusal to heed the pleas of a majority of the beneficiaries of the trust, the business and reputation of Schalk Chemical Company were adversely affected to an extremely serious and near catastrophic extent.

(8) From 1944 to 1948 the other beneficiaries of the trust employed every available means, including removal litigation, to neutralize the control of Schalk Chemical Company by Horace O. Smith, Jr.

#### Settlement

(9) The lawsuit to remove Horace O. Smith, Jr., and the dispute between the beneficiaries concerning the policies and management of Schalk Chemical Company were settled by an agreement dated January 15, 1948, under which Horace O. Smith, Jr., resigned as Supervisor of the trust and as an officer and director of Schalk Chemical Company and agreed to secure the resignations of the

officers and directors of Schalk Chemical Company whom he had caused to be elected and dominated.

(10) Without deviation, Horace O. Smith, Jr., insisted that the settlement agreement be with the other beneficiaries of the trust and not with the corporation and that it include the purchase of his one-sixth beneficial interest for a price of \$45,000.00, of which \$25,000.00 was to be paid to him immediately and \$20,000.00 on termination of the trust in 1950.

(11) The sole motivation of the other beneficiaries in entering into the agreement in 1948 with Horace O. Smith, Jr., was their desire to relieve Schalk Chemical Company of the onerous and extremely detrimental effect of his domination and control of the company.

(12) Pursuant to the agreement, but for the use and benefit of Schalk Chemical Company, the other beneficiaries paid \$25,000.00 to Horace O. Smith, Jr., in 1948 and his resignation and the resignations of his nominees were effectuated.

#### Assignment Agreement

(13) On December 29, 1950, under an authorizing resolution of its Board of Directors adopted on December 15, 1950, Schalk Chemical Company entered into an assignment agreement with the other beneficiaries of the trust under which their rights under the 1948 agreement were assigned to the com-

pany and the company assumed the obligation to pay \$20,000.00 to Horace O. Smith, Jr., and agreed to reimburse with interest the \$25,000.00 which had been paid to Horace O. Smith, Jr., in 1948 on behalf and for the benefit of the company.

(14) On termination of the trust Schalk Chemical Company received the distributive share of Horace O. Smith, Jr.

#### Dividend Issue

(15) In 1951, in pursuance of the assignment agreement, Schalk Chemical Company paid \$20,000.00 to Horace O. Smith, Jr., and paid \$25,000.00 to the other parties to the assignment agreement, of which Petitioner Hazel I. Farman received \$15,000.00.

(16) No part of the \$20,000.00 paid by Schalk Chemical Company to Horace O. Smith, Jr., or the \$15,000.00 paid by Schalk Chemical Company to Petitioner Hazel I. Farman in 1951 was a dividend or a distribution essentially equivalent to a dividend to Petitioners.

Wherefore, Petitioners request that the Honorable Tax Court hear this proceeding and determine:

(1) That Petitioners received no dividend from Schalk Chemical Company in 1951; and

(2) That there is no deficiency due from Petitioners for the taxable year 1951.

Respectfully submitted,

/s/ HUGH W. DARLING,  
Counsel for Petitioners.

Duly verified.

Received and filed August 20, 1956, T.C.U.S.

Served August 22, 1956.

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[Title of Tax Court and Cause.]

Docket No. 63855

ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayers, admits, denies, and alleges as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

Denies the allegations of error contained in paragraph IV of the petition.

V.

With regard to the facts upon which petitioners rely in seeking a redetermination of the alleged deficiency,

(1) through (6) Admits the allegations contained in subparagraphs (1) through (6) of paragraph V of the petition.

(7) and (8) Denies the allegations contained in subparagraphs (7) and (8) of paragraph V of the petition.

(9) Admits the allegations contained in subparagraph (9) of paragraph V of the petition.

(10) through (13) Denies the allegations contained in subparagraphs (10) through (13) of paragraph V of the petition.

(14) Admits the allegations contained in subparagraph (14) of paragraph V of the petition.

(15) and (16) Denies the allegations contained in subparagraphs (15) and (16) of paragraph V of the petition.

## VI.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Further answering the petition, the respondent alleges as follows:

## VII.

That the petitioners filed their individual income tax return (joint) for the year 1951 on March 12, 1952; that in said return petitioners reported gross income in the amount of \$17,364.38.

## VIII.

That the petitioners had a gross income for the

said taxable year in the amount of \$44,364.38; that there was omitted from the gross income so reported by petitioners in said year an amount properly includible therein of \$27,000; that the last stated amount represented income derived by petitioners during said taxable year; that said amount is in excess of 25 per centum of the gross income stated in the return.

## IX.

That within five years after the filing by petitioners of their return for the taxable year 1951, and on May 23, 1956, the Commissioner sent to the petitioners, by registered mail, the notice of deficiency from which petitioners' appeal is taken; that said notice of deficiency is the basis of the present proceeding.

## X.

The premises considered, the involved notice of deficiency in respect of petitioners' taxable year 1951 was timely sent by the Commissioner to the petitioners.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ JOHN POTTS BARNES, R.E.M.

Chief Counsel, Internal  
Revenue Service.

Filed October 2, 1956, T.C.U.S.

Entered October 4, 1956.

Served October 4, 1956.

[Title of Tax Court and Cause.]

Docket No. 63862

## PETITION

Petitioners John Carver Baker and Patricia Baker respectfully petition the Tax Court of the United States for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated May 23, 1956, and in support of their petition allege:

### I.

In 1951 Petitioners were husband and wife. They now are divorced. Petitioner John Carver Baker resides at 2219 Ocean Avenue, Santa Monica, California. Petitioner Patricia Baker resides at 94 Esperanza, Sierra Madre, California. Their joint income tax return for the year 1951, with which this proceeding is concerned, was filed with the Collector of Internal Revenue for the Sixth District of California, Los Angeles, California.

### II.

The notice of deficiency dated May 23, 1956 (copy of which is attached and marked Exhibit "A"), was mailed to Petitioners on or after the date of the notice.

### III.

The Commissioner has determined a deficiency in income tax for the year 1951 in the amount of \$2,465.86, all of which is in controversy.



IV.

The determination of tax liability set forth in the notice of deficiency is based on these errors:

(1) The Commissioner erred in determining that Petitioners received dividends in the amount of \$9,000.00 from Schalk Chemical Company in the year 1951.

(2) The Commissioner erred in determining that Petitioners omitted from their gross income for the year 1951 an amount in excess of 25% of the gross income reported by them and in failing to find that assessment of additional income tax for the year 1951 is barred by Section 275 (a) of the Internal Revenue Code of 1939.

V.

The facts upon which Petitioners rely in seeking a redetermination of the alleged deficiency are:

Preliminary Facts

(1) Petitioners filed a timely joint Federal income tax return for the year 1951, reporting an adjusted gross income of \$5,620.55.

(2) Schalk Chemical Company is a corporation organized in 1903 and existing under the laws of the State of California, having its principal place of business at 351 East Second Street, Los Angeles, California, and has issued and outstanding 100,000 shares of its capital stock, 16,666 of which since 1951 have been held as treasury shares.

(3) Petitioner Patricia Baker in 1951 owned

and now owns 16,667 shares of the capital stock of Schalk Chemical Company.

### The Trust

(4) From 1930 to 1950 the outstanding shares of Schalk Chemical Company were the principal asset of an express trust created on December 29, 1930. At all times material to this case prior to the termination of the trust Petitioner Patricia Baker had a one-sixth beneficial interest and her brother, Horace O. Smith, Jr., a one-sixth beneficial interest in the trust.

(5) The declaration of trust designated alternate "Supervisors," each of whom while in office was to have the equivalent of plenary power of management over the trust and Schalk Chemical Company, including the power and right to appoint a majority of the Board of Directors of Schalk Chemical Company and the power and right to vote all the shares of Schalk Chemical Company, all of which were to be issued in the name of the trustee bank, except shares needed to qualify the directors.

(6) In 1942 Horace O. Smith, Jr., then 28 years of age, succeeded to the office of Supervisor of the trust, being one of the designated alternates, and by virtue of that office thereafter and until 1948 dominated and controlled the Board of Directors of Schalk Chemical Company and in consequence held domination and control of Schalk Chemical Company.

(7) As a result of the domination and control of Schalk Chemical Company by Horace O. Smith, Jr., his lack of experience and judgment and his unflinching refusal to heed the pleas of a majority of the beneficiaries of the trust, the business and reputation of Schalk Chemical Company were adversely affected to an extremely serious and near catastrophic extent.

(8) From 1944 to 1948 the other beneficiaries of the trust employed every available means, including removal litigation, to neutralize the control of Schalk Chemical Company by Horace O. Smith, Jr.

#### Settlement

(9) The lawsuit to remove Horace O. Smith, Jr., and the dispute between the beneficiaries concerning the policies and management of Schalk Chemical Company were settled by an agreement dated January 15, 1948, under which Horace O. Smith, Jr., resigned as Supervisor of the trust and as an officer and director of Schalk Chemical Company and agreed to secure the resignations of the officers and directors of Schalk Chemical Company whom he had caused to be elected and dominated.

(10) Without deviation, Horace O. Smith, Jr., insisted that the settlement agreement be with the other beneficiaries of the trust and not with the corporation and that it include the purchase of his one-sixth beneficial interest for a price of \$45,000.00, of which \$25,000.00 was to be paid to him immedi-

ately and \$20,000.00 on termination of the trust in 1950.

(11) The sole motivation of the other beneficiaries in entering into the agreement in 1948 with Horace O. Smith, Jr., was their desire to relieve Schalk Chemical Company of the onerous and extremely detrimental effect of his domination and control of the company.

(12) Pursuant to the agreement, but for the use and benefit of Schalk Chemical Company, the other beneficiaries paid \$25,000.00 to Horace O. Smith, Jr., in 1948 and his resignation and the resignations of his nominees were effectuated.

#### Assignment Agreement

(13) On December 29, 1950, under an authorizing resolution of its Board of Directors adopted on December 15, 1950, Schalk Chemical Company entered into an assignment agreement with the other beneficiaries of the trust under which their rights under the 1948 agreement were assigned to the company and the company assumed the obligation to pay \$20,000.00 to Horace O. Smith, Jr., and agreed to reimburse with interest the \$25,000.00 which had been paid to Horace O. Smith, Jr., in 1948 on behalf and for the benefit of the company.

(14) On termination of the trust Schalk Chemical Company received the distributive share of Horace O. Smith, Jr.

Dividend Issue

(15) In 1951, in pursuance of the assignment agreement, Schalk Chemical Company paid \$20,000.00 to Horace O. Smith, Jr., and paid \$25,000.00 to the other parties to the assignment agreement, of which Petitioner Patricia Baker received \$5,000.00.

(16) No part of the \$20,000.00 paid by Schalk Chemical Company to Horace O. Smith, Jr., or the \$5,000.00 paid by Schalk Chemical Company to Petitioner Patricia Baker in 1951 was a dividend or a distribution essentially equivalent to a dividend to Petitioners.

Wherefore, Petitioners request that the Honorable Tax Court hear this proceeding and determine:

- (1) That Petitioners received no dividend from Schalk Chemical Company in 1951;
- (2) That assessment of additional income tax for the year 1951 is barred by Section 275 (a) of the Internal Revenue Code of 1939; and
- (3) That there is no deficiency due from Petitioners for the taxable year 1951.

Respectfully submitted,

/s/ HUGH W. DARLING,  
Counsel for Petitioners.

Duly verified.

Received and filed August 20, 1956, T.C.U.S.

Served August 22, 1956.

[Title of Tax Court and Cause.]

Docket No. 63862

### ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayers, admits, denies, and alleges as follows:

#### I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

#### IV.

Denies the allegations of error contained in paragraph IV of the petition.

#### V.

(1) through (6) With regard to the facts upon which petitioners rely in seeking a redetermination of the alleged deficiency, admits the allegations contained in subparagraphs (1) through (6) of paragraph V of the petition.

(7) and (8) Denies the allegations contained in subparagraphs (7) and (8) of paragraph V of the petition.

(9) Admits the allegations contained in subparagraph (9) of paragraph V of the petition.

(10) through (13) Denies the allegations contained in subparagraphs (10) through (13) of paragraph V of the petition.

(14) Admits the allegation contained in subparagraph (14) of paragraph V of the petition.

(15) and (16) Denies the allegations contained in subparagraphs (15) and (16) of paragraph V of the petition.

#### VI.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Further answering the petition, the respondent alleges as follows:

#### VII.

That the petitioners filed their individual income tax return (joint) for the year 1951 on March 15, 1952; that in said return petitioners reported gross income in the amount of \$6,740.55.

#### VIII.

That the petitioners had a gross income for the said taxable year in the amount of \$15,740.55; that there was omitted from the gross income so reported by petitioners in said year an amount properly includible therein of \$9,000; that the last stated amount represented income derived by petitioners during said taxable year; that said amount is in excess of 25 per centum of the gross income stated in the return.

## IX.

That within five years after the filing by petitioners of their return for the taxable year 1951, and on May 23, 1956, the Commissioner sent to the petitioners, by registered mail, the notice of deficiency from which petitioners' appeal is taken; that said notice of deficiency is the basis of the present proceeding.

## X.

The premises considered, the involved notice of deficiency in respect of petitioners' taxable year 1951 was timely sent by the Commissioner to the petitioners.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ JOHN POTTS BARNES, R.E.M.  
Chief Counsel, Internal  
Revenue Service.

Filed October 2, 1956, T.C.U.S.

Entered October 4, 1956.

Served October 4, 1956.

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[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855 and 63862

## STIPULATION OF FACTS

It Is stipulated and agreed by and between the parties hereto, through their respective counsel of



record, that for the purposes of the above cases the facts stated herein shall be taken as true and the exhibits attached hereto shall be admissible in evidence without further foundation, subject to the right of either party to object to the admission of such evidence on the grounds of materiality and relevancy; provided, however, that either party may introduce other and further evidence not inconsistent with the evidence herein stipulated:

1. Petitioner Schalk Chemical Company (referred to herein as "Schalk") is a corporation organized and existing under the laws of the State of California. Schalk was incorporated on October 9, 1903.

2. Petitioner Hazel I. Farman was the wife of Horace O. Smith until his death on December 9, 1928. They were the parents of petitioner Patricia Farman Baker (born September 14, 1925), Evelyn Smith Marlow (born February 1, 1913), and Horace O. Smith, Jr. (born December 13, 1913). Hazel I. Farman became the wife of petitioner Gerald I. Farman on August 14, 1931. Petitioner John Carver Baker is the former husband of Patricia Farman Baker.

3. At all times material to these cases, the accounts and income of Schalk have been maintained and reported on a calendar-year, accrual basis, and the accounts and income of the individual petitioners have been maintained and reported on a calendar-year, cash basis.

4. At all times material to these cases prior to 1951 Schalk had issued and outstanding 100,000 shares of its capital stock. In 1951 Schalk acquired the 16,666 shares now held in its treasury.

5. The present shareholders of Schalk and the number of shares of the capital stock of Schalk owned by each are:

|                            |               |
|----------------------------|---------------|
| Hazel I. Farman.....       | 50,000 shares |
| Patricia Farman Baker..... | 16,667 shares |
| Evelyn Smith Marlow.....   | 16,667 shares |

6. From December 29, 1930, to December 29, 1950, the 100,000 issued and outstanding shares of Schalk were the principal asset of an express trust (referred to herein as the "trust") created on December 29, 1930. A true copy of the Declaration of Trust by which the trust was created is attached hereto as Exhibit "1."

7. Horace O. Smith, the father of Patricia Farman Baker, Evelyn Smith Marlow and Horace O. Smith, Jr., died testate on December 9, 1928. The trust referred to in paragraph 6 was created in pursuance of a Stipulation and Agreement dated September 26, 1929, entered into in settlement of a will contest filed by Hazel I. Farman and in pursuance of the Final Decree of Distribution in the Matter of the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125, in which the Stipulation and Agreement was incorporated. Ratification of the Stipulation and Agreement by

the guardian of the minor children was authorized by Order dated November 29, 1929, in the Matter of the Guardianship of the children, Los Angeles Superior Court No. 103528.

8. The term of the trust expired on December 29, 1950, in accordance with the provisions of the Declaration of Trust and the corpus of the trust was distributed to the beneficiaries in 1951.

9. Three "Supervisors" were named in the Declaration of Trust to serve severally in the order named. The first, Frank A. Maginnis, refused to serve. The second, Curtis C. Colyear, served as Supervisor of the trust from 1930 until his decease in 1943. The third, Horace O. Smith, Jr., held that office from 1943 until his resignation in 1948. He was succeeded by Stanley W. Guthrie, who in 1948 was appointed Supervisor of the trust by Court order in the Matter of the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125. Stanley W. Guthrie acted as Supervisor for the balance of the term of the trust.

10. Pursuant to the designation of Curtis C. Colyear, then Supervisor of the trust and President of Schalk, Horace O. Smith, Jr., was elected director of Schalk in 1939. In 1942 Horace O. Smith, Jr., was elected President of Schalk. Horace O. Smith, Jr., remained director and President of Schalk until his resignation of those offices on January 15, 1948.

11. On September 26, 1945, G. I. Farman was

elected a director of Schalk at the instance of Evelyn Smith Marlow and Patricia Farman Baker pursuant to the power to designate a director reserved to them under the Declaration of Trust. Thereafter and until the first election of directors following the termination of the trust on December 29, 1950, G. I. Farman served as a director of Schalk as designee of Evelyn Smith Marlow and Patricia Farman Baker.

12. On April 11, 1947, Evelyn Smith Marlow and Patricia Farman Baker filed an action in the Superior Court of the State of California in and for the County of Los Angeles, No. 528,107. True copies of the pleadings (exhibits thereto omitted), memoranda, stipulations, minute orders, dismissal as to certain parties, stipulated judgment and notice of entry of judgment filed and entered in said action are collectively attached hereto as Exhibit "2." Original stipulations executed but not filed with the Court in said action are collectively attached hereto as Exhibit "3."

13. On January 15, 1948, concurrently with and in pursuance of an agreement executed and entered into on that date:

(a) Horace O. Smith, Jr., resigned as Supervisor of the trust and as director and President of Schalk.

(b) Henry O. Wackerbarth resigned as director and Secretary of and as Attorney for Schalk.

(c) Henry J. Rausch resigned as director and Auditor of Schalk.

(d) Hazel I. Farman, Evelyn Smith Marlow and Patricia Farman Baker executed and delivered releases in favor of the persons named in (a), (b) and (c), and in favor of Howard Lieben and Elmer J. Jensen, former directors of Schalk. True copies of the releases are collectively attached hereto as Exhibit "4."

(e) Horace O. Smith, Jr., was paid and received the sum of \$25,000.00.

14. On December 15, 1950, the Board of Directors of Schalk held a meeting, a true copy of the minutes of which is attached hereto marked Exhibit "5."

15. In 1951 Schalk paid the sum of \$20,000.00 to Horace O. Smith, Jr., the sum of \$17,364.38 to Hazel I. Farman, and the sum of \$5,788.13 each to Patricia Farman Baker and Evelyn Smith Marlow. Of such sums, the amount of \$2,364.38 paid to Hazel I. Farman and the amounts of \$788.13 paid to Patricia Farman Baker and Evelyn Smith Marlow, respectively, are claimed by Schalk to be interest at the rate of 5% per annum from January 15, 1948.

\* \* \*

17. As of December 31, 1947, the book value of the issued and outstanding stock of Schalk was \$1.33 per share.

18. Post-1913 accumulated earnings and profits of Schalk as of December 31 1949, amounted to \$68,956.10.

19. For the calendar year 1950, Schalk filed a Federal Income Tax Return in which it deducted, among other deductions, the sum of \$45,000.00 as a business expense and the sum of \$3,697.92 as accrued interest. The tax return shows a net loss of \$692.79. The Commissioner has disallowed both of these deductions (the interest being disallowed specifically under Section 23(b) of the Internal Revenue Code of 1939), and the alleged deficiency in tax resulting from such adjustments is \$15,087.22. If the Commissioner's disallowances be sustained in full, then Schalk would have a net taxable income of \$47,603.13 for the year 1950 instead of a loss. No formal dividends were declared or paid by Schalk in 1950. Schalk's Federal Income Tax Return for the year 1950 is attached hereto as Exhibit "A."

20. For the calendar year 1951 petitioners Gerald I. Farman and Hazel I. Farman filed a joint Federal Income Tax Return in which the Commissioner contends they should have included the sum of \$27,000 (3/5ths of \$45,000) as dividend income from Schalk. The alleged deficiency in tax resulting from the adjustment is \$11,589.98. Mr. and Mrs. Farman's Federal Income Tax Return for the calendar year 1951 is attached hereto as Exhibit "B."

21. For the calendar year 1951 petitioners John Carver Baker and Patricia Farman Baker filed a

joint Federal Income Tax Return in which they reported adjusted gross income of \$5,620.55. The Commissioner has treated the sum of \$9,000 (1/5th of \$45,000) as properly includible but omitted dividend income from Schalk and has disallowed \$520.00 of claimed automobile expense. In addition, these petitioners omitted interest in the sum of \$788.13 paid to them by Schalk in 1951. The alleged deficiency in tax resulting from these adjustments is \$2,465.86. Mr. and Mrs. Baker's Federal Income Tax Return for the calendar year 1951 is attached hereto as Exhibit "C."

22. No consents extending the statutory period of assessment for any of the years in question were executed by any of the taxpayers involved herein, except Schalk. A consent extending until June 30, 1955, the period of assessment of income taxes for the taxable year ended December 31, 1950, was executed by Schalk on November 23, 1953, and by the Commissioner on December 1, 1953. A consent extending until June 30, 1956, the period of assessment of income taxes for the taxable year ended December 31, 1950, was executed by Schalk on June 13, 1955, and by the Commissioner on June 24, 1955.

23. The notices of deficiency which are the subject of these cases were issued on May 23, 1956. The petitions herein were filed on August 20, 1956.

HUGH W. DARLING, and  
DONALD KEITH HALL,

By /s/ DONALD KEITH HALL,  
Counsel for Petitioners.

/s/ ARCH M. CANTRALL, R.E.M.  
Chief Counsel, Internal  
Revenue Service.

Filed at trial July 16, 1958.

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[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855 and 63862

#### STIPULATION OF FACTS—B

It is stipulated and agreed by and between the parties hereto, through their respective counsel of record, that for the purposes of the above cases the facts stated herein shall be taken as true:

1. Horace O. Smith, Deceased, at his death on December 9, 1928, owned 49,934 shares of the capital stock of Schalk Chemical Company. On that date, Sierra Chemical Company, a California corporation, owned 50,000 shares of the capital stock of Schalk Chemical Company. The total capital stock of Schalk Chemical Company on December 9, 1928, consisted of 100,000 shares.

2. Horace O. Smith, Deceased, at his death on December 9, 1928, also owned 55,000 shares of the capital stock of Sierra Chemical Company. On that date, the remaining 45,000 shares outstanding of the capital stock of Sierra Chemical Company were



owned by Graselli Chemical Company, an Ohio corporation.

3. After the death of Horace O. Smith, the Executor of his Estate acquired the 45,000 shares of the capital stock of Sierra Chemical Company which were owned by Graselli Chemical Company and thereafter caused Sierra Chemical Company to be dissolved.

July 28, 1958.

HUGH W. DARLING, and  
DONALD KEITH HALL,

By /s/ DONALD KEITH HALL,  
Counsel for Petitioners.

/s/ ARCH M. CANTRALL, R.E.M.  
Chief Counsel, Internal  
Revenue Service.

Filed at trial July 22, 1958.

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[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855, 63862

### FINDINGS OF FACT AND OPINION

1. Corporation, on an accrual basis, held not entitled to deduct as an ordinary and necessary business expense a liability it voluntarily assumed in 1950 to reimburse three beneficiaries of a spendthrift trust, which held all of its stock, for a down payment of \$25,000 made by them in 1948, pur-

suant to the terms of an agreement with S, the fourth beneficiary, wherein S agreed to sell, and they agreed to buy, for \$45,000, his one-sixth minority interest in the stock of the corporation at the termination of the trust. .

2. Corporation held not to be entitled to deduct as an ordinary and necessary expense, or as interest, the amount of the liability it assumed in 1950 to reimburse the three beneficiaries for the interest they had paid on money borrowed to make the \$25,000 down payment.

3. Three beneficiaries held to have received a dividend from corporation to the extent that they participated in the distribution made by it in 1951, to reimburse them for the \$25,000 down payment.

4. Three beneficiaries held to have received a distribution essentially equivalent to the distribution of a dividend in 1951, when the corporation satisfied their contractual obligation to pay the \$20,000 balance of the purchase price of S's one-sixth minority stock interest at the termination of the trust.

5. Assessment of deficiencies determined against individual petitioners held not barred by statute of limitations.

Donald K. Hall, Esq., for the petitioners.

Marion Malone, Esq., and J. Earl Gardner, Esq., for the respondent.

Respondent determined the following deficiencies in income tax:

| Year | Docket Number | Petitioner                                    | Deficiency  |
|------|---------------|---|-------------|
| 1950 | 63853         | Schalk Chemical Company.....                  | \$15,087.22 |
| 1951 | 63855         | Gerald I. Farman and<br>Hazel I. Farman.....  | 11,589.98   |
| 1951 | 63862         | John Carver Baker and<br>Patricia Baker ..... | 2,465.86    |

The issues are:

1. Was the amount of \$45,000 paid by Schalk Chemical Company to Hazel I. Farman, Patricia Baker, Evelyn Marlow and Horace O. Smith, Jr., or any part thereof, deductible by it as a business expense in 1950?

2. Was the amount of \$3,697.92, paid by Schalk Chemical Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow, deductible by it as interest, or as a business expense, in 1950?

3. Was the amount of \$25,000 paid by the Schalk Chemical Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow during the year 1951, a dividend?

4. Did any part of the \$20,000 paid by Schalk Chemical Company in 1951 to Horace O. Smith, Jr., constitute a dividend, or a distribution essentially equivalent to a dividend, to Hazel I. Farman and Patricia Baker, or either of them?

5. Did petitioners John Carver Baker and Patricia Baker and petitioners Gerald I. Farman

and Hazel I. Farman omit from their gross income for the year 1951, an amount properly includible therein which is in excess of 25 per centum of gross income stated in their returns?

### Findings of Fact

Some of the facts have been stipulated and, as stipulated, they are incorporated herein by reference.

Schalk Chemical Company (hereinafter referred to as "Schalk") was organized in 1903 under the laws of the State of California. It manufactures and distributes nationally a line of associated paint products and home repair products. Its books were kept and its returns filed on an accrual basis.

Schalk filed its Federal income tax return for the year 1950 with the then collector of internal revenue, Los Angeles, California. In that return it deducted, among other expenses, the amount of \$45,000 as a business expense and the amount of \$3,697.92 as accrued interest. Respondent disallowed both of these deductions (the interest being disallowed under Section 23(b) of the Internal Revenue Code of 1939).

Gerald I. Farman and Hazel I. Farman, husband and wife, filed a joint income tax return for the year 1951, on March 12, 1952, with the then collector of internal revenue at Los Angeles, California. Therein they reported gross income of \$17,364.38 and net income of \$14,341.63. Respondent deter-

mined that they received from Schalk during 1951, dividends of \$27,000 ( $\frac{3}{5}$ ths of \$45,000), and the deficiency determined against them results from the addition of this amount to the net income reported in their 1951 return.

John Carver Baker and Patricia Baker, then husband and wife, filed a joint income tax return for the year 1951, on March 15, 1952, with the then collector of internal revenue, Los Angeles, California. In this return they reported gross income of \$6,740.55 and net income of \$5,058.49. In determining the deficiency against them, the respondent adjusted the net income reported in their return by disallowing \$520 of claimed automobile expense and adding \$788.13 for omitted interest income and \$9,000 ( $\frac{1}{5}$ th of \$45,000) for dividends received from Schalk during 1951. Petitioners do not contest the automobile expense and interest adjustments.

Respondent's notices of deficiency to petitioners were issued on May 23, 1956. The petitioners filed their petitions in this Court on August 20, 1956.

Consents extending until June 30, 1956, the period of assessment of income taxes for the year 1950, were executed by Schalk and respondent. No consents extending the period of assessment for any of the taxable years were executed by the other petitioners.

In 1928 Horace O. Smith died testate, being survived by his widow, Hazel I. Smith (now Hazel I. Farman); their three children, Evelyn Smith (now

Evelyn Smith Marlow), Horace O. Smith, Jr., and Patricia Smith (now Patricia Baker); and his mother, Charlotte E. Wood. The children were minors at the time, being 15, 14 and 3 years of age, respectively.

A will contest was filed by decedent's widow which was settled by a Stipulation and Agreement dated September 26, 1929. Pursuant to the Stipulation and Agreement and Final Decree of Distribution in the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125, a spendthrift trust was created, the principal asset of which consisted of all the then issued and outstanding stock (100,000 shares) of Schalk.

The trust came into being on December 29, 1930, for a term of twenty years, expiring on December 29, 1950.

The beneficiaries of the trust were Hazel I. Smith (now Hazel I. Farman), Charlotte E. Wood, Evelyn Smith (now Evelyn Smith Marlow), Horace O. Smith, Jr., and Patricia Smith (now Patricia Baker). Hazel I. Smith became the wife of petitioner Gerald I. Farman on August 14, 1931.

After the demise of Charlotte E. Wood, prior to 1940 (the children succeeding to her 12½ per cent interest pro rata) and until termination of the trust on December 29, 1950, the beneficial interests were:

|                               |     |          |
|-------------------------------|-----|----------|
| Hazel I. Farman . . . . .     | 50  | per cent |
| Evelyn Smith Marlow . . . . . | 16⅔ | per cent |

|                              |                           |
|------------------------------|---------------------------|
| Horace O. Smith, Jr. . . . . | 16 $\frac{2}{3}$ per cent |
| Patricia Baker . . . . .     | 16 $\frac{2}{3}$ per cent |

The Declaration of Trust appointed three persons to serve successively as “supervisor,” each of whom while in office was to have the equivalent of absolute power of management over the trust and Schalk, including the power and right to appoint a majority (three out of a total of five members), of the Board of Directors of Schalk and the power and right to vote all the shares of Schalk.

The first named supervisor refused to serve. The second, Curtis C. Colyear, served from 1930 until his decease in 1943. The third, Horace O. Smith, Jr., held the office until his resignation in 1948. He was succeeded by Stanley W. Guthrie, who was appointed by Court order and who acted as supervisor for the remainder of the term of the trust.

As supervisor of the trust and director and President of Schalk from 1943 to 1948, and through officers and directors which he caused to be elected, Horace O. Smith, Jr., dominated and controlled the Board of Directors of Schalk and in consequence dominated and controlled the management and policies of Schalk.

Hazel I. Farman was a “minority director” by virtue of the terms of the Declaration of Trust. Gerald I. Farman was appointed a “minority director” in 1945 by Evelyn Smith Marlow and Patricia Baker, pursuant to the power to designate

a director reserved to them under the Declaration of Trust.

After Smith became supervisor of the trust and president of Schalk, the other beneficiaries of the trust made a number of suggestions to Smith and the officers and directors of Schalk he had caused to be appointed which they thought were in the best interests of Schalk. These suggestions related in part to sales promotion, new products, advertising costs, and automatic equipment. Because of the failure of the corporation to adopt and follow many of these suggestions controversies arose between Smith and the other beneficiaries of the trust. Attempts to settle these controversies by setting up an executive committee composed of Smith, Hazel I. Farman, and Gerald I. Farman (Smith's stepfather) to manage the company and by permitting Gerald I. Farman to fill the position of vice president and expediter of raw materials, were unsuccessful. In April, 1947, Evelyn Smith Marlow and Patricia Baker filed suit to remove Smith, as supervisor of the trust. This suit and the controversy between Smith and the other beneficiaries of the trust were settled, after extended negotiations, by an agreement dated January 15, 1948 (hereinafter sometimes referred to as the settlement agreement), resulting in the elimination of Smith's interest in and control over Schalk and the payment to Smith of \$25,000 in 1948 and \$20,000 in 1951. During the course of the negotiations leading to the settlement agreement, the other beneficiaries of the trust pro-



posed that the settlement be by agreement between Smith and Schalk. Smith rejected their proposals that Schalk be a party to the agreement or pay any part of the money which he was demanding. He insisted upon dealing directly with the other beneficiaries.

The foregoing settlement agreement of January 15, 1948, by and between Horace O. Smith, Jr., First Party, and Hazel I. Farman, Evelyn Smith Marlow and Patricia Farman Baker, Second Parties, provided in part as follows:

For and in consideration of the sum of \$25,000 to First Party in hand paid by Second Parties, receipt of said sum being hereby acknowledged by First Party, First Party agrees to sell to Second Parties jointly and severally, and Second Parties jointly and severally agree to buy from First Party, subject to the terms and conditions herein contained, upon the termination and distribution of that certain trust dated December 29, 1930 \* \* \* all of the then right, title and interest of First Party in and to the corpus and any accumulations thereof then belonging or distributed to First Party.

On or before thirty days after the termination of said Trust No. 1071 (which said termination date is hereby agreed as being the 29th day of December, 1950), and the actual distribution by the trustee of the corpus and accumulated assets of the trust estate to the beneficiaries then entitled to receive the same, Second Parties jointly and severally agree

to pay to First Party the sum of \$20,000 in then current funds of the United States of America, less the amount of any distribution of any type or character whatsoever, including income, made by said trustee to First Party subsequent to the date hereof and prior to the date of final distribution of the trust estate.

It is understood and agreed that this agreement shall not be intended or construed as an assignment or transfer by First Party of any present right, title or interest of First Party in or to said trust or to the corpus or income thereof, and that no transfer of any interest of First Party in or to said trust, or in or to any corpus or income therefrom, shall be made by First Party until said trust has terminated and the corpus and any accumulated income thereon shall have been distributed to First Party.

It is distinctly understood and agreed that First Party agrees to sell and Second Parties agree to buy all of the assets of said Trust No. 1071 distributed to First Party upon the termination of said trust in whatever form said assets distributable to First Party may then exist, including cash, stocks, securities and real and personal property of every kind, nature and description whatsoever. In the event that First Party's beneficial or distributable interest in said trust shall for any reason be increased by reason of the terms and provisions of said trust agreement subsequent to the date hereof and prior to the actual distribution to First Party, such increase shall be included as a part of the prop-

erty to be transferred by First Party to Second Parties hereunder.

Within five days after actual distribution by the trustee of said trust to First Party of the property herein agreed to be sold to Second Parties, or notice that said beneficial interest of First Party in said trust is ready for distribution to First Party, First Party agrees to deposit into an escrow to be opened with Security-First National Bank of Los Angeles or Bank of America National Trust and Savings Association, in the City of Los Angeles, all of the property of every kind, nature and description received by First Party and agreed to be sold hereunder, together with such bills of sale, deeds, conveyances, assignments, or other instruments as may be necessary to vest title thereto in Second Parties, with instructions to deliver all thereof to Second Parties or their assignees upon the payment to First Party of the sum of \$20,000.00, less the amount of any distributions made to First Party from said trust subsequent to the date hereof as hereinbefore provided. First Party shall likewise deposit concurrently in said escrow an itemized statement of any such distributions made to him by said trust and shall notify Second Parties of the opening of said escrow.

Second Parties agree within twenty-five days after the receipt of such notice to deposit into such escrow the balance of the purchase price herein provided, and upon receipt of said sum said escrow holder shall be instructed to close said escrow and

distribute the remainder of said purchase price to First Party, and the property herein provided to be sold to Second Parties or their assigns, the costs and expenses of said escrow to be paid by Second Parties. Any taxes assessed against the transfer of all property to be sold by First Party hereunder shall be paid by First Party promptly when due.

Said escrow instructions shall provide that if Second Parties or their assigns fail, neglect or refuse to deposit in the aforesaid escrow, within the time and subject to the conditions herein contained, the balance remaining of the aforesaid purchase price, then all property and documents deposited by First Party in said escrow shall immediately be returned to First Party on demand and said escrow shall be terminated.

In consideration of First Party agreeing to resign as supervisor of the trust hereinbefore described and as officer and director of Schalk Chemical Company, a corporation, and of his securing the resignation of Henry O. Wackerbarth as an officer, director and attorney for said corporation, and of H. T. Rausch as a director and auditor of said corporation, the parties hereto agree to enter into a stipulation for the entry of a judgment in the action in the Superior Court of the State of California in and for the County of Los Angeles, entitled Evelyn Smith Marlow and Patricia Farman Baker, as Plaintiffs, vs. Union Bank and Trust Co. of Los Angeles, a corporation, et al., as Defendants, and numbered 528,107 in said Court, which

said stipulation is being entered into concurrently herewith.

In the event that Second Parties, their heirs, successors, or assigns, shall fail, neglect or refuse to pay the balance of the purchase price as herein provided, First Party shall be released from any and all obligation to sell, transfer, convey or assign the property herein described, and Second Parties, their heirs, successors and assigns, shall be released of any and all obligations to purchase said property or to pay to First Party any additional moneys hereunder.

The entire purchase price for the property herein agreed to be sold by First Party to Second Parties shall be the sum of \$45,000.00, less any distributions made by First Party from said trust as herein provided, and the sum of \$25,000.00 paid by Second Parties as consideration to First Party for entering into this agreement shall, in the event Second Parties, their heirs, successors or assigns, comply fully and promptly with the terms and conditions hereof, be applied towards said total purchase price.

This agreement may be assigned by Second Parties, their heirs, successors and assigns, at any time during the term hereof.

First Party agrees, immediately upon request from Second Parties so to do, to apply for and use his best efforts to secure a policy of life insurance insuring the life of First Party, in such form and with such insurance company as Second Parties

may request, in the principal sum of \$25,000.00, with Second Parties as joint and several beneficiaries thereunder. Second Parties jointly and severally agree to pay the initial and all subsequent premiums and costs in connection with the securing of said policy, and immediately upon the issuance thereof, said policy shall be delivered to and become the property of Second Parties, First Party assuming no liability as to the payment of premiums thereon. Any dividends on said policy shall become the property of Second Parties and no change of beneficiaries shall be made without the consent of Second Parties, First Party hereby agreeing to join in and consent to any change of beneficiaries upon request of Second Parties so to do.

Time is to be and is of the essence of this agreement.

This agreement shall inure to the benefit of the heirs, executors and assigns of the parties hereto.

At a special meeting of the board of directors of Schalk, held on January 15, 1948, Horace O. Smith, Jr., presented to the board his resignation as supervisor of the trust and as an officer and director of Schalk and also the resignations of the officers and directors of Schalk whom he had caused to be elected, and resolutions were adopted accepting these resignations.

On January 15, 1948, Hazel I. Farman, Patricia Baker, and Evelyn Smith Marlow paid Horace O. Smith, Jr., the amount of \$25,000. Hazel I. Farman

paid \$15,000, and Patricia Baker and Evelyn Smith Marlow each paid \$5,000. Hazel I. Farman and Patricia Baker borrowed the money to make their portions of the \$25,000 payment. The promissory notes given by them for the loans were due and payable on or before January 15, 1951, and bore interest at the rate of five per cent per annum.

As of December 31, 1947, the book value of the issued and outstanding stock of Schalk was \$1.33 per share. Schalk had done a considerable amount of advertising over a long period of years, and it was the concensus of its board of directors that it had established an extensive good will for its products. No amount for good will was shown on its books.

By resolution of the board of directors of Schalk, adopted on December 15, 1950, Schalk was authorized to accept an assignment of the settlement agreement as of December 29, 1950, provided Horace O. Smith, Jr., survived that date; to assume the obligations to Hazel I. Farman, Evelyn Smith Marlow and Patricia Baker under the settlement agreement; to pay them the amount of \$25,000 with interest at five per cent from January 15, 1948; and to pay to Smith the amount of \$20,000 upon delivery to Schalk of all the property received by Smith as a distributive beneficiary of the trust.

As of December 29, 1950, Hazel I. Farman, Evelyn Smith Marlow and Patricia Baker, as "First Parties" and Schalk as "Second Party" entered into an agreement. Therein the First Parties as-

signed to Schalk all of their rights and interests in the settlement agreement of January 15, 1948; Schalk accepted the assignment and assumed and agreed to be bound by all of the obligations of Hazel I. Farman, Evelyn Smith Marlow and Patricia Baker therein; and Schalk agreed to pay them the amount of \$25,000, plus interest at five per cent per annum from January 15, 1948.

In February, 1951, Schalk paid \$20,000 to Union Bank & Trust Co. of Los Angeles for the account of Horace O. Smith, Jr., \$17,364.38 to Hazel I. Farman, and \$5,788.13 each to Patricia Baker and Evelyn Smith Marlow. Of such sums the amount of \$2,364.38 paid to Hazel I. Farman and the amounts of \$788.13 paid to Patricia Baker and Evelyn Smith Marlow, respectively, are claimed by Schalk to be interest at the rate of five per cent per annum from January 15, 1948.

On February 28, 1951, Horace O. Smith, Jr., and Schalk executed escrow instructions to Union Bank & Trust Co. of Los Angeles whereby Schalk deposited \$20,000 to be paid to Horace O. Smith, Jr., when the Bank held for the benefit of Schalk, pursuant to Court order, the 16,666 shares which otherwise would have been distributed to Horace O. Smith, Jr.

On March 20, 1951, an order was entered in the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125, directing that there be distributed to Hazel I. Farman 50,000 shares, to



Evelyn Smith Marlow 16,667 shares, to Patricia Baker 16,667 shares and to Schalk 16,666 shares, of the stock of Schalk.

No formal dividends were declared or paid by Schalk in 1951.

The net profit or loss (before taxes) of Schalk for the years 1942 through 1951 was as follows:

| Year | Net Profit or Loss<br>(Before Taxes) |
|------|--------------------------------------|
| 1942 | \$18,170.84                          |
| 1943 | 63,280.34                            |
| 1944 | 77,526.87                            |
| 1945 | 46,867.94                            |
| 1946 | 95,030.80                            |
| 1947 | (32,158.67)                          |
| 1948 | 26,504.07                            |
| 1949 | 5,252.45                             |
| 1950 | 47,603.13*                           |
| 1951 | 8,638.91                             |

Post-1913 accumulated earnings and profits of Schalk as of December 31, 1950, totalled \$67,861.31.

Petitioners Gerald I. Farman and Hazel I. Farman, and petitioners John Carver Baker and Patricia Baker omitted from their gross income for the year 1951 an amount properly includible therein in excess of 25 per centum of the amount of gross income reported in their returns.

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\*Does not include the deductions of \$45,000 and \$3,697.92 which are at issue.

## Opinion

Raum, Judge: Schalk accrued on its books and deducted in its return for 1950 the liability, which it assumed in the Assignment Agreement of December 29, 1950, to pay \$45,000 to Hazel I. Farman, Patricia Baker, Evelyn Marlow and Horace O. Smith, Jr., and interest at 5 per cent per annum on \$25,000 from January 15, 1948. The respondent disallowed the claimed deduction. Petitioners now concede that \$20,000 of the \$45,000 is not deductible by Schalk, but contend that the remaining \$25,000 plus the interest is deductible by it as an ordinary and necessary business expense.

In support of their contention, petitioners argue that the settlement agreement was not a purchase and sale agreement although cast in the form of one; that therein, for \$25,000, Smith agreed to resign as supervisor of the trust and as an officer and director of Schalk (and to obtain the resignation of the officers and directors whom he had caused to be elected or maintained in office); and, for \$20,000, Smith granted to Hazel I. Farman, Patricia Baker and Evelyn Marlow (hereinafter referred to as the other beneficiaries) an option to purchase for \$20,000 the stock interest in Schalk distributed to him upon termination of the trust. Assuming this construction of the agreement to be correct, they argue that the \$25,000 payment made by the other beneficiaries to Smith at the time of the execution of the agreement was justified and necessary for the preservation of the business of

Schalk; that if Schalk had paid, or by resolution of its board of directors had authorized the payment of, the \$25,000, this amount would have been deductible by Schalk; that, disregarding form, the substance of the transaction was that it was authorized by the "majority owners" (the other beneficiaries) on behalf of and for the benefit of Schalk, and, therefore, by Schalk; that Schalk was, therefore, morally obligated to reimburse the other beneficiaries for the \$25,000 payment and for interest on the money they borrowed in order to make that payment; and that when it assumed the obligation to reimburse them it became entitled to deduct \$25,000 and interest in the amount of \$3,697.92.

After Smith became supervisor of the trust in 1943 the other beneficiaries, led by Gerald I. Farman, Smith's stepfather, became dissatisfied with the management and policies of Schalk. Suggestions made by them which they thought were in the best interests of Schalk were not followed by Smith and the officers and directors whom he had caused to be appointed. In April, 1947, Evelyn Smith Marlow and Patricia Baker filed a suit to have Smith removed as supervisor. Demurrers to the complaint were sustained, and during the period that the plaintiffs might have filed an amended complaint, representatives of Smith and the other beneficiaries entered into negotiations to settle the controversy. During these negotiations Smith offered to sell his interest in the trust and resign as supervisor of the trust and officer and director of Schalk. The other

beneficiaries suggested that Schalk purchase Smith's interest in the trust. Smith refused, and insisted that any settlement agreement had to be between Smith, as an individual, and the other beneficiaries, as individuals.

The parties to the settlement agreement were in fact the other beneficiaries and Smith. Schalk was not a party to, and did not authorize the other beneficiaries to enter into, the agreement. Petitioners' argument that the agreement was nevertheless informally authorized by Schalk and that it was, therefore, obligated in equity and good conscience to reimburse the other beneficiaries for the \$25,000 payment made by them, is without merit. Their reasoning is that the other beneficiaries beneficially owned  $83\frac{1}{3}$  per cent of Schalk; that as "majority owners" they were acting on behalf of and solely for the benefit of Schalk and for the preservation of its business when they entered into the agreement; and that their action was in substance the action of Schalk. This reasoning overlooks the fact that the trust agreement, which created their beneficial interests, placed complete control of Schalk in Smith, the supervisor of the trust, and prevented them from acting for or on its behalf. Not having any power to act for Schalk, we fail to see how any action taken by them can be deemed to be the action of Schalk. Moreover, we think petitioners place undue stress on the benefits to Schalk from the settlement agreement and not enough on the benefits they were seeking for themselves. The other beneficiaries sought the resignation of Smith as su-

pervisor of the trust because they were dissatisfied with the management and policies of the corporation under his regime and wanted to acquire the right, which they did not have, to participate in its management and control. We are satisfied that they thought their participation would be beneficial to the corporation, but we are not convinced that the management of the corporation under Smith was incompetent and that their action was either necessary or desirable to preserve its business. If the anticipated benefit to the corporation materialized they would benefit personally therefrom as income beneficiaries of the trust whose principal asset was the stock of Schalk. In the circumstances we think it reasonable to assume that they were not overlooking that benefit and that their action in entering into the settlement agreement was motivated to some extent, if not entirely, by the benefits they thought would accrue to them personally. In any event, Schalk did not authorize them to act, formally or informally, and it was not obligated, morally or legally, to reimburse them for the \$25,000 they paid pursuant to the terms of the settlement agreement. Its failure to do so distinguishes the facts here involved from those in cases such as *Catholic News Publishing Co.*, 10 T.C. 73, cited by petitioners.

There being no obligation on the part of Schalk to reimburse the other beneficiaries for the \$25,000 payment made by them in 1948, its action approximately three years later in agreeing to reimburse them for that payment together with the interest

they had paid on money they borrowed to make it, and for assuming their remaining obligations under the settlement agreement, did not, in our judgment, result in an ordinary or necessary business expense.

Moreover, we do not agree with petitioners that the consideration the other beneficiaries received for the \$25,000 payment was the resignation of Smith as supervisor of the trust and as an officer and director of Schalk. Smith agreed to resign if the other beneficiaries would purchase his one-sixth minority interest in the stock of Schalk at the termination of the trust. Under the terms of the settlement agreement he received no cash consideration for his resignation. Therein the other beneficiaries agreed to pay him \$45,000 for his stock interest, \$25,000 of which was to be paid at the time of the execution of the agreement and the remaining \$20,000 on or before thirty days after the termination of the trust. The provision relating to the \$25,000 payment reads, in part, as follows:

For and in consideration of the sum of \$25,000.00 to First Party [Smith] in hand paid by Second Parties [the other beneficiaries] \* \* \* First Party agrees to sell \* \* \* and Second Parties \* \* \* agree to buy \* \* \* upon the termination and distribution of that certain trust dated December 29, 1930 \* \* \* all of the then right, title and interest of the First Party in and to the corpus and any accumulations thereof then belonging or distributed to First Party. (Underscoring supplied.)

It is apparent from this provision of the agreement that \$25,000 was the down payment the other beneficiaries obligated themselves to make (and made) at the time of the execution of the agreement in consideration for Smith's agreement to sell them his minority stock interest at the termination of the trust. If Schalk had made this payment in the first instance, it clearly would not have been entitled to deduct it as an ordinary and necessary business expense because it was part of the purchase price of an asset, particularly in the absence of a satisfactory showing that the purchase price was excessive. Its character was not changed by reason of the fact that Schalk assumed the obligation to reimburse, and did reimburse, the other beneficiaries for the payment made by them. Respondent did not err in determining that Schalk was not entitled to any ordinary and necessary expense deduction in 1950 when it voluntarily agreed to reimburse the other beneficiaries for the \$25,000 payment, and for the interest they had paid on the money they had borrowed to make this payment.

Petitioners make the alternative contention that if the liability assumed by Schalk to reimburse the other beneficiaries for interest in the amount of \$3,697.92 is not deductible as a business expense, then it is deductible as "interest." This amount is clearly not deductible as "interest" as there was no indebtedness on the part of Schalk on which interest could accrue.

Petitioners' next contention is that the respond-

ent erred in determining that the payment of \$25,000 made by Schalk to the other beneficiaries in 1951 constituted a dividend to Hazel I. Farman and Patricia Baker in that year to the extent that they participated in the receipt of the payment.

The trust in which the other beneficiaries owned beneficial interests in the stock of Schalk terminated on December 29, 1950. On that date, for all practical purposes, Hazel I. Farman became the owner of 50,000 shares, Patricia Baker 16,667 shares, and Evelyn Smith Marlow 16,667 shares, although the order directing distribution was not entered until March 20, 1951. In February, 1951, Schalk made a distribution to them of \$25,000. Hazel I. Farman received \$15,000 of this amount and Patricia Baker and Evelyn Smith Marlow \$5,000 each, which were the amounts each of them had paid to Smith at the time of the execution of the settlement agreement.

A dividend is defined in Section 115(a), Internal Revenue Code of 1939, as "any distribution made by a corporation to its stockholders \* \* \* out of its earnings or profits \* \* \*." A distribution of corporate earnings may constitute a dividend notwithstanding that the formalities of a dividend declaration are not observed, and that it is not in proportion to stockholdings. *Paramount-Richards Theatres, Inc., v. Commissioner*, 153 F. 2d 602, 604 (C.A. 5), affirming a Memorandum Opinion of this Court.

On December 31, 1950, Schalk had post-1913 accumulated earnings and profits substantially in ex-



cess of the \$25,000 distributed in February, 1951, and the other beneficiaries who received that distribution were in full control of the corporation. It reimbursed them for the down payment they made and were obligated to make, pursuant to the terms of the settlement agreement, in consideration for Smith's agreement to sell them his minority interest in the stock of Schalk at the termination of the trust. As already noted, Schalk was not a party to the settlement agreement, did not authorize the payment, and was not obligated, legally or morally, to reimburse them therefor. Its action in reimbursing them for the payment was, therefore, voluntary, and in the absence of any evidence by petitioners that the amount distributed to them did not come from its accumulated earnings and profits, the distribution constituted a dividend as defined in Section 115(a), *supra*. Respondent did not err in his determination that the individual petitioners, to the extent that they participated in the distribution, received a dividend.

The third contention of petitioners is that the respondent erred in determining that the payment by Schalk of \$20,000 in 1951 constituted a distribution essentially equivalent to a dividend to Hazel I. Farman and Patricia Baker to the extent that the corporation discharged a contractual obligation of these petitioners.

The respondent contends that Schalk in 1951 made a \$20,000 distribution in redemption of the minority interest in its stock held by Smith, which

the other beneficiaries were contractually obligated to purchase under the terms of the settlement agreement, and that such a distribution is essentially the equivalent of a dividend to them since it operated to discharge their obligation.

Petitioners urge that the settlement agreement gave the other beneficiaries a mere option to purchase Smith's minority stock interest at the time of the termination of the trust, which they did not exercise; that they assigned the option to Schalk; and that the exercise of the option by Schalk did not benefit them directly or indirectly in any appreciable degree and did not discharge any obligation of theirs which would result in a distribution essentially equivalent to the receipt of a dividend. Petitioners cite *Holsey v. Commissioner*, 258 F. 2d 865 (C.A. 3), reversing 28 T.C. 962.

Petitioners rely on the paragraph of the settlement agreement which provides that if the other beneficiaries should "fail, neglect or refuse to pay the balance of the purchase price," \$20,000, Smith would be released from any obligation to sell his one-sixth stock interest and the other beneficiaries "shall be released of any and all obligations to purchase" the same "or to pay \* \* \* any additional moneys" to Smith.

This isolated provision of the settlement agreement merely restricts the remedy of Smith, in the event the other beneficiaries default and fail to pay the \$20,000 balance of the purchase price, to the retention of the \$25,000 down payment. Somewhat

similar provisions in other contracts have been held not to give the purchaser a mere option to purchase where other provisions thereof clearly indicate that it was the intention of the parties to enter into a binding contract for the purchase and sale of property. See *Vance v. Roberts*, 93 Fla. 379, 118 So. 205; *Wright v. Suydam*, 72 Wash. 587, 131 P. 239; and cf. *Rodriguez v. Barnett*, 333 P. 2d 407 (Cal. App. 1958). Here the settlement agreement provides that, "It is distinctly understood and agreed that First Party [Smith] agrees to sell and Second Parties [the other beneficiaries] agree to buy all of the assets of said Trust \* \* \* distributed to First Party upon the termination of said trust \* \* \*" and that the "First Party agrees to sell \* \* \* and Second Parties jointly and severally agree to buy \* \* \* all of the then right, title and interest of First Party in and to the corpus and accumulations \* \* \* of the trust."

Our conclusion is that the other beneficiaries were obligated under the terms of the settlement agreement to purchase, and Smith to sell, Smith's minority interest in the stock of Schalk; that the purchase price was \$45,000, \$25,000 of which was payable at the time of the execution of the agreement and the remaining \$20,000 when the trust terminated; and that the provision upon which petitioners rely did not convert the binding contract for the purchase and sale of Smith's interest into a mere option. When Schalk paid the \$20,000 it satisfied a contractual obligation of the other beneficiaries, two of whom, Hazel I. Farman and Patricia

Baker, are petitioners in these proceedings. Had the other beneficiaries made the payment it would have cost them \$20,000 and they would have become the owners of all of Schalk's outstanding stock. When Schalk assumed their obligation and paid \$20,000 in redemption of the 16,666 shares of its stock held by Smith, the other beneficiaries became the owners of all of its outstanding stock without cost to themselves. When the transaction was concluded therefore the other beneficiaries were in substantially the same position they would have been in if Schalk had not assumed their obligation and had distributed to them \$20,000 and they had used this money to satisfy their obligation to purchase the portion of Schalk's outstanding stock, owned by Smith, which they did not then own. In the circumstances we are convinced that the respondent did not err in his determination that the \$20,000 payment by Schalk in 1951 constituted a distribution essentially equivalent to a dividend to Hazel I. Farman and Patricia Baker to the extent that Schalk discharged their contractual obligation, and we so hold. *Wall v. United States*, 164 F. 2d 462 (C.A. 4); *Zipp v. Commissioner*, 259 F. 2d 119 (C.A. 6), affirming 28 T.C. 314; *Garden State Developers, Inc.*, 30 T.C. 135.

The remaining issue is whether the assessment of deficiencies, determined against petitioners Gerald I. Farman and Hazel I. Farman, and petitioners John Carver Baker and Patricia Baker for the year 1951, is barred by the statute of limitations. Deficiency notices were mailed to them within five

years, but not within three years, after their 1951 returns were filed. Assessment of the deficiencies is, therefore, barred under Section 275(c), Internal Revenue Code of 1939, if they did not omit from their gross income for 1951 an amount properly includible therein in excess of 25 per centum of the reported gross income. In view of our holding in respect of the dividend issue, simple arithmetic demonstrates that there was an omission of more than 25 per cent of gross income; accordingly, assessment of the deficiencies is not barred under Section 275(c).

Decisions will be entered for the respondent.

Filed July 9, 1959.

Served July 9, 1959.

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The Tax Court of the United States,  
Washington  
Docket No. 63853

SCHALK CHEMICAL COMPANY, a California  
Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 9, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1950 in the amount of \$15,087.22.

/s/ ARNOLD RAUM,  
Judge.

Entered July 21, 1959.

Served July 22, 1959.

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The Tax Court of the United States,  
Washington

Docket No. 63855

GERALD I. FARMAN and HAZEL I. FARMAN,  
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 9, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1951 in the amount of \$11,589.98.

/s/ ARNOLD RAUM,  
Judge.

Entered July 21, 1959.

Served July 22, 1959.

The Tax Court of the United States,  
Washington

Docket No. 63862

JOHN CARVER BAKER and PATRICIA  
BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 9, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1951 in the amount of \$2,465.86.

/s/ ARNOLD RAUM,  
Judge.

Entered July 21, 1959.

Served July 22, 1959.

In the United States Court of Appeals  
for the Ninth Circuit

Tax Court Dockets Nos. 63853, 63855 and 63862

SCHALK CHEMICAL COMPANY, a California Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

GERALD I. FARMAN and HAZEL I. FARMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISIONS  
OF THE TAX COURT OF THE UNITED  
STATES

To the Honorable Judges of the United States  
Court of Appeals for the Ninth Circuit:

Schalk Chemical Company, a California corporation,  
Gerald I. Farman and Hazel I. Farman, and



John Carver Baker and Patricia Baker, and each of them, through their attorney of record, respectfully petition the United States Court of Appeals for the Ninth Circuit to review the decisions of The Tax Court of the United States entered in the above cases on July 21, 1959, pursuant to its findings of fact and opinion filed July 9, 1959 (32 T.C. No. 76), ordering and deciding:

“That [in the case of Schalk Chemical Company] there is a deficiency in income tax for the taxable year 1950 in the amount of \$15,087.22.”

“That [in the case of Gerald I. Farman and Hazel I. Farman] there is a deficiency in income tax for the taxable year 1951 in the amount of \$11,589.98.”

“That [in the case of John Carver Baker and Patricia Baker] there is a deficiency in income tax for the taxable year 1951 in the amount of \$2,465.86.”

The cases were consolidated in the Tax Court for the purposes of trial and opinion.

This petition for review is taken and filed pursuant to the provisions of Sections 7482 and 7483 and other applicable sections of the Internal Revenue Code of 1954, as amended.

#### Nature of Controversy

The asserted tax liabilities which are involved in these cases stem principally from:

(1) Respondent's and the Tax Court's disallowance of Schalk Chemical Company's deduction, as an ordinary and necessary business expense, of a liability which it assumed to reimburse amounts which its present shareholders borrowed and paid to a former minority shareholder, who at the time owned a one-sixth beneficial interest in the stock of the Company but who by reason of the terms of a spendthrift trust the principal asset of which consisted of all the stock of the Company had absolute control of the Company and power to vote all its stock. The money was paid, petitioners contend, on behalf of the Company and for its benefit and the preservation and protection of its business and reputation to free the Company from domination by the particular individual, in circumstances which would have led persons of ordinary prudence to act in similar fashion. The Company could not act in any respect except as the minority shareholder might permit. For personal reasons he refused to allow the Company to make or authorize the payments to himself. The individual petitioners in good faith acted to protect the Company in the only way that it was possible for them to act.

(2) Respondent's and the Tax Court's determination that such reimbursements constituted distributions essentially equivalent to dividends to the individual petitioners.

(3) Respondent's and the Tax Court's determination that the subsequent redemption of the minority shareholder's one-sixth stock interest re-

sulted in constructive dividends to the individual petitioners.

Petitioners respectfully urge that the Tax Court's rulings on these and other issues are contrary to law and are not supported by the evidence. Particularly in regard to (3) above, the Tax Court, in petitioners' opinion, erroneously interprets the settlement agreement under which Schalk Chemical Company was relieved of absolute domination and control by the minority shareholder as obligating the individual petitioners to purchase his one-sixth stock interest upon subsequent termination and distribution of the assets of the trust from which his extraordinary powers over the Company flowed.

The distinctive feature of these cases is that for a period of twenty years, from December, 1930, to December, 1950, the outstanding stock of Schalk Chemical Company was the principal asset of a spendthrift trust. The beneficiaries were of one family.

Under the terms and designations in the trust instrument entered into when the children were minors, a son having a one-sixth beneficial interest in the trust eventually (in 1943) succeeded to the office of "Supervisor" of the trust with the extraordinary right to exercise by himself absolute power and control over the management and policies of the Company. He excluded the other members of the family including his mother (their beneficial interests under the trust aggregating 83 $\frac{1}{3}$ %) from any voice in the management of the Company and

over a period of several years dominated the Company following a policy of preservation of the status quo and of nonexpansion and nondevelopment of products which the other members of the family believed was adverse to the best interests of the Company and was endangering its future, especially in view of the fact that the Company's specialty field had become highly competitive in the post-war years.

In 1947 the Company suffered a substantial operating loss and its working capital became seriously depleted. Fearing that the Company would fail or would be wasted to an extent from which it could not recover before the trust terminated and the son lost the power and control which he had by virtue of the trust, the other members of the family in January, 1948, finally succeeded in securing his resignation as "Supervisor" of the trust and as president and director of the Company and the resignations of the directors and officers which he had appointed.

It is this settlement, the later assumption by the Company of the amounts paid in connection therewith and the redemption of the son's one-sixth distributive stock interest on termination of the trust which give rise to the questions presented on this review.

#### Court in Which Review Is Sought

The United States Court of Appeals for the Ninth Circuit is the Court in which review of the above

decisions of The Tax Court of the United States is sought pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954, as amended.

### Venue

Schalk Chemical Company is a corporation organized and operating under the laws of the State of California. Its Federal income tax return for the taxable year 1950 was filed with the Collector (now District Director) of Internal Revenue for the Sixth District of California, in which collection district taxpayer's principal office and place of business was (and now is) located.

Gerald I. Farman and Hazel I. Farman are husband and wife. Their joint Federal income tax return for the taxable year 1951 was filed with the Collector (now District Director) of Internal Revenue for the Sixth District of California, in which collection district taxpayers were (and now are) residing.

In 1951 John Carver Baker and Patricia Baker were husband and wife. Their joint Federal income tax return for the taxable year 1951 was filed with the Collector (now District Director) of Internal Revenue for the Sixth District of California, in which collection district taxpayers were (and now are) residing.

The office of the Collector (now District Director) of Internal Revenue for the Sixth District of California to which the foregoing returns were made

in respect of which the alleged additional tax liabilities of the respective petitioners arise was (and now is) located at Los Angeles, California, within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

The parties have not stipulated that the decisions of the Tax Court herein referred to may be reviewed by any other United States Court of Appeals.

Wherefore, it is respectfully requested that the decisions and related findings of fact and opinion of the Tax Court of the United States herein referred to be reviewed by the United States Court of Appeals for the Ninth Circuit.

/s/ DONALD KEITH HALL,  
Attorney for Petitioners.

Received and filed October 19, 1959, T.C.U.S.

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[Title of Court of Appeals and Cause.]

Tax Court Dockets Nos. 63853, 63855 and 63862

NOTICE OF FILING PETITION  
FOR REVIEW

To: Hart H. Spiegel, Esquire, Chief Counsel, Internal Revenue Service, Washington, D. C.

You Are Hereby Notified that the above-named petitioners on October 15, 1959, duly mailed to the

Clerk of The Tax Court of the United States, at Washington, D. C., for filing, a petition for review by the United States Court of Appeals for the Ninth Circuit of the decisions of the Tax Court heretofore rendered in the above-entitled cases.

A copy of the petition for review as mailed for filing is hereto attached and served on you.

October 15, 1959.

/s/ DONALD KEITH HALL,  
Attorney for Petitioners.

Affidavit of Service by Mail attached.

Received and filed October 19, 1959, T.C.U.S.

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The Tax Court of the United States

Dockets Nos. 63853, 63855, 63862

In the Matter of:

SCHALK CHEMICAL COMPANY, et al.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

TRANSCRIPT OF PROCEEDINGS

Wednesday, July 16, 1958

The above-entitled matter came on for hearing pursuant to notice, at 10:00 o'clock a.m.

Before: The Honorable Arnold Raum.

Appearances:

MR. DONALD KEITH HALL,  
Appearing for Petitioners.

MR. MARION MALONE, and  
MR. J. EARL GARDNER,  
Appearing for Respondent.

The Clerk: Dockets Nos. 63853, 63855, 63862,  
Schalk Chemical Company, and related Petitioners.

Mr. Hall: Ready for Petitioners, your Honor.

The Court: State your appearances.

Mr. Hall: For Petitioner Donald Keith Hall.

Mr. Malone: For the Respondent, Marion Malone and J. Earl Gardner.

The Court: Have these cases been consolidated?

Mr. Malone: Your Honor, we expect to move that the cases be consolidated.

Mr. Hall: I have no objection, your Honor.

The Court: You wish to make that motion now?

Mr. Malone: I wish to make the motion that they be consolidated for trial, as well as for brief.

Mr. Hall: That is agreeable with Petitioners.

The Court: The motion will be granted. And I will treat the stipulation of facts which has already been filed as applicable to all three cases, as consolidated.

Mr. Hall: Yes, your Honor.

The Court: There is attached to the stipulation exhibits.

Mr. Hall: I will identify——



The Court: From 1 through 5, and also A through C. Proceed.

Mr. Hall: Your Honor, at this time I would like to identify for the record, if it is the proper procedure, Mr. May [3\*] suggested that the exhibits be identified for the record in connection with the stipulation, and I would like to offer them at this time in evidence.

The Court: They are already in evidence as a result of the stipulation, stipulations having been filed. [4]

\* \* \*

Mr. Hall: Your Honor, I have three documents which Government Counsel has reviewed and I believe we have agreed that they may be admitted without any foundation.

And I will designate them and show them to Counsel then, and then I will offer them.

The first is escrow instructions, dated February 28, 1959, of Union Bank and Trust Company of Los Angeles.

The second document——

The Court: Do you offer that one now? [36]

\* \* \*

At this time, your Honor, I offer the escrow instructions that I have just described.

The Court: Admitted.

The Clerk: Petitioners' Exhibit No. 6.

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\*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(The document above referred to was marked Petitioner's Exhibit No. 6 and was received in evidence.)

Mr. Hall: The next document is 14 and final report and account current of trustee petition for approval and allowance of fees of trustee, and for final distribution of trust estate.

Mr. Gardner: No objection.

The Court: Admitted. [37]

Mr. Hall: I offer this as Petitioner's Exhibit No. 7.

(The document above referred to was marked Petitioner's Exhibit No. 7 for identification, and was received in evidence.)

Mr. Hall: Final document is order settling final account and report of trustee and for fees in the superior court of the State of California, and for the County of Los Angeles.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Petitioner's Exhibit No. 8.

(The document above referred to was marked Petitioner's Exhibit No. 8 for identification, and was received in evidence.)

Mr. Hall: I call Mr. Brinton.

CHARLES BRINTON

a witness called by and in behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and your address, please.

The Witness: Charles Brinton, B-r-i-n-t-o-n.  
My address is 3680 Fair Meade Road, Pasadena.

The Clerk: California?

The Witness: Yes.

The Clerk: Thank you. [38]

Direct Examination

By Mr. Hall:

Q. Mr. Brinton, what is your profession?

A. I am a certified public accountant.

Q. Are you acquainted with Schalk Chemical Company?      A. I am.

Q. When did you first become acquainted with Schalk Chemical Company?      A. In early 1947.

Q. What was the nature of your contact with the company, at that time?

A. As an employee of Henry Rausch, certified public accountant, I conducted the audit of Schalk Chemical Company as of December 31, 1946.

Q. Did you do the same thing as to the account of Schalk Chemical Company for the year 1947?

A. I conducted the audit of Schalk Chemical Company for 1947; however, at that time I was a partner, rather than an employee of Mr. Rush.

Mr. Hall: May I ask that this document be marked Petitioner's Exhibit 9 for identification?

(Testimony of Charles Brinton.)

The Clerk: Petitioner's Exhibit No. 9 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 9 for [39] identification.)

Q. (By Mr. Hall): Mr. Brinton, I hand you a document which has been marked Petitioner's Exhibit 9 for identification; do you recognize that document? A. I do.

Q. What is it?

A. It is the audit report of Schalk Chemical Company for the year ended December 31, 1947.

Mr. Hall: I offer this document in evidence as Petitioner's Exhibit No. 9, your Honor.

Mr. Malone: Respondent objects to the admission of this document in evidence on the ground that it is not related to any of the years involved in this action; it is irrelevant and immaterial.

Mr. Hall: Your Honor, it is relevant on this position of the company, at the time of the settlement, which took place on January 15, 1948.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 9 was received in evidence.)

Mr. Hall: Would you please mark that as Petitioner's Exhibit No. 10 for identification.

The Clerk: Petitioner's Exhibit 10 marked for identification. [40]

(Testimony of Charles Brinton.)

(The document above referred to was marked  
Petitioner's Exhibit No. 10 for identification.)

Q. (By Mr. Hall): Mr. Brinton, I hand you a document which has been marked Exhibit 10 for identification; do you recognize that document?

A. Yes; I do.

Q. What is it?

A. This is a summary of gross sales and net profit or loss before taxes for the years 1937 through 1947, for Schalk Chemical Company.

Q. Did you assist me in the preparation of Exhibit 10 for identification?      A. I did.

Q. From what source were the figures obtained which are shown on Exhibit 10 for identification?

A. These figures came from the audit report for the respective years.

Mr. Hall: I have given Counsel for the Government a copy of it, and I offer this document in evidence as Exhibit 10.

Mr. Malone: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 10 was received in evidence.) [41]

Mr. Hall: Please mark this as Exhibit 11 for identification.

The Clerk: Petitioner's Exhibit No. 11 marked for identification.

(Testimony of Charles Brinton.)

(The document above referred to was marked  
Petitioner's Exhibit No. 11 for identification.)

Q. (By Mr. Hall): Mr. Brinton, I hand you document marked Petitioner's Exhibit 11 for identification; do you recognize that document?

A. I do.

Q. What is it?

A. This is a statement of the profit or loss for each month during the year 1947, of Schalk Chemical Company, together with a figure for the profit or loss from January 1 to the end of each month during that same year.

Q. Did you assist me in the preparation of Exhibit 11 for identification?      A. I did.

Q. From what source were the figures obtained which are shown on Exhibit 11 for identification?

A. These figures were obtained from profit and loss statements prepared by the company's accountant at the end of each month during 1947. [42]

Q. What was Schalk Chemical Company practice at that time, and what is it now, with regard to company prepared financial statements?

A. At the end of each month the accountant would prepare a balance sheet, a statement of profit and loss for the year to date, and a statement of profit and loss for the month just ended. These records have been prepared from the books of the general ledger of Schalk Chemical Company.

Mr. Hall: I offer that document, your Honor, as

(Testimony of Charles Brinton.)

Petitioner's Exhibit 11 for identification, as Petitioner's Exhibit 11.

Mr. Malone: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 11, was received in evidence.)

Q. By Mr. Hall): Mr. Brinton, there is a footnote on Exhibit 11; would you state the effect of the adjustment that is there described on the net result of operations in the month of April, 1947?

A. Yes. In the month of April, 1947, an entry was made setting up an account prepaid advertising, which represents a deferred expense. By reason of this entry [43] having been made in the month of April, the profit as reflected by this statement has been increased by \$22,000 as a result of this entry.

Q. In other words, without the adjustment there would have been a loss in the month of April, 1947?

A. That is correct.

Mr. Hall: Mr. Clerk, would you mark this document as Petitioner's Exhibit 12 for identification as Petitioner's Exhibit 12 for identification?

The Clerk: Petitioner's Exhibit 12 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 12 for identification.)

(Testimony of Charles Brinton.)

Q. (By Mr. Hall): Mr. Brinton, I hand you a document marked Petitioner's Exhibit No. 12 for identification; do you recognize that document?

A. I do.

Q. What is it?

A. This is a statement reflecting the inventory of January 1, the purchases during the year, and the inventory as of December 31 for Schalk Chemical Company, for the years 1942 through 1947.

Q. Did you assist me in the preparation of [44] Exhibit No. 12 for identification? A. I did.

Q. From what source were the figures obtained which are shown on Exhibit 12 for identification?

A. These figures were obtained from the audit reports for the respective years.

Mr. Hall: I offer this document as Petitioner's Exhibit 12.

Mr. Malone: Respondent would like to ask whether the audit reports from which these are taken are available in the courtroom?

Mr. Hall: In answer to Mr. Malone's question, the audit reports are here, and I might state for the Court's benefit, that Government Counsel reviewed all of the audit reports for 1937 to '57, before we came to court.

The Court: Are they in the courtroom now?

Mr. Hall: Yes; they are. I have them, your Honor.

Mr. Malone: No objection to the document.

The Court: Admitted.



(Testimony of Charles Brinton.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 12 was received in evidence.)

Q. (By Mr. Hall): Now, Mr. Brinton, have you computed the ratio of Schalk's cost of goods sold to gross sales in 1940, [45] based on the audit report of Schalk Chemical Company for that year?

A. Yes; I did.

Q. What was the ratio in 1940?

A. In 1940 the ratio of cost of goods sold to gross sales was 34 per cent.

Q. Based on Schalk's 1947 audit report, which is Exhibit, Petitioner's Exhibit 9 in evidence, what was the comparable ratio in 1947?

A. In 1947 the ratio of cost of goods sold to gross sales was somewhat in excess of—it was approximately 44.4 per cent.

Mr. Hall: You may examine.

#### Cross-Examination

By Mr. Malone:

Q. Mr. Brinton, you first became employed with Schalk in 1947; is that correct?

A. With——

Q. Schalk Chemical Company.

A. I was retained—well, my employer was retained in 1947, yes. That is, he was retained prior years, as well, but my first association was in 1947.

Q. And your association entitled you to the examination of all the books and records for Schalk?

(Testimony of Charles Brinton.)

A. Yes. [46]

Q. For 1947. Did you ever have occasion to look into the records of the company for prior years?

A. Yes.

Q. Did you look into the audit reports that were made by Henry Rausch for the years from 1942 through 1947, did you ever have occasion to look at those? A. I have.

Mr. Malone: Your Honor, the Respondent would like to offer for its next in order for identification a document purportedly an audit report of the Schalk Chemical Company for the year ended December 31, 1942.

The Clerk: Respondent's Exhibit D marked for identification.

(The document above referred to was marked Respondent's Exhibit D for identification.)

Mr. Hall: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Respondent's Exhibit D was received in evidence.)

Q. (By Mr. Malone): Mr. Brinton, I hand you this Respondent's Exhibit D for identification.

The Court: That is in evidence now.

Mr. Malone: I offered it, your Honor, for identification. [47]

The Court: Well, when Petitioner's Counsel indicated no objection, I assumed that it was then

(Testimony of Charles Brinton.)

being offered in evidence, and I admitted it. However, if you do not wish it offered, I will order it stricken.

Mr. Malone: I do not care to have it offered at this time, your Honor.

The Court: All right. The Reporter will then indicate that Exhibit D for identification is not in evidence.

(Respondent's Exhibit D, previously admitted in evidence, was withdrawn.)

Q. (By Mr. Malone): Mr. Brinton, will you examine this document; will you state to the Court whether you have ever seen it before?

A. Yes; I have seen this statement before.

Q. Will you look at Exhibit A, to this document, and state what you see as the total current assets for the year ending December 31, 1942?

Mr. Hall: Your Honor, I object to the question on the ground that it is not proper cross-examination. I don't believe the year '42, except as to the ending figures on the profit and loss statement, were gone into on direct, nor—and also, the inventory and purchases.

But if we are going to go into, if it is the Government's position that it is material to go into [48] the whole financial statement in each of these years, I am willing to offer all of the audit reports for this period, and they can make the argument they wish from it.

This witness stated that he was not acquainted

(Testimony of Charles Brinton.)

with Schalk prior to the year 1947, and if we are getting to specific questions about specific accounts, and so forth, this witness is not qualified to answer it.

Mr. Malone: Your Honor, the witness has stated on cross that he had occasion to examine the books and records of the company prior to the time of his employment, and the question directed to him is merely a preliminary statement, asking him to repeat information which he can receive by looking at the document.

The Court: Do you plan ultimately to offer Exhibit D in evidence?

Mr. Malone: Yes, your Honor.

The Court: Since there has been no objection to it, and since this witness probably cannot add any more than what appears in the document itself, I suggest that you offer it, unless you think you can get some kind of illuminating testimony from the witness, other than reading from the document, what appears there.

Mr. Malone: Well, your Honor, there is considerable amount of material in this document, and the testimony that the Respondent wished to bring out is comparative statements as to certain of the facts which appear in the [49] document so that it would be of convenience to the Court, not to have to bother of looking at the entire, through all the figures and entries that are made on that record.

Mr. Hall: Your Honor, I make the offer at this time for the benefit of Government Counsel, that

(Testimony of Charles Brinton.)

I will take this stack of audit reports and we can number each separately, and we will introduce them and they can make whatever argument that he wants from the face of the audit reports, and I believe that is all that Counsel is going to do, and he attempts, when he attempts this examination of Mr. Brinton.

The Court: I assume Government Counsel could make up schedules similar to what appear in such matters as Exhibits 10, 11 and 12, which the Petitioner presented.

Mr. Hall: Which I did simply.

The Court: And that such schedules could be made up from the audit reports.

Mr. Malone: Well, if Respondent may have leave to submit such schedules, we have no objection, or would like to offer these documents into evidence now. All of those for the years 1942 through 1946, I believe Petitioner has offered document, the audit report for the year 1947 into evidence.

The Court: You now offer the audit reports from 1942 through 1946? [50]

Mr. Malone: Yes, your Honor.

The Court: They will be received and the Clerk will give them identifying symbols.

Mr. Hall: Pardon, your Honor, I didn't hear.

(Record read.)

Mr. Malone: Respondent offers five documents individually, the audit reports for Schalk Chemi-

(Testimony of Charles Brinton.)

cal Company, first of which is for the year ended December 31, 1942. Respondent offers this in evidence.

The second audit report is for the year ended December 31, 1943, which Respondent offers into evidence.

The Clerk: The first one will be Respondent's Exhibit D; the second one is Respondent's Exhibit E.

(The documents above referred to were marked Respondent's Exhibits D and E for identification.)

Mr. Malone: Respondent offers the audit for, audit report for Schalk Chemical Company for the year ended December 31, 1944, in evidence.

The Clerk: Respondent's Exhibit F.

(The document above referred to was marked Respondent's Exhibit F for identification.)

Mr. Malone: Respondent offers audit for the year ended December 31, 1945, for the year ended December 31, 1946, they are all in evidence. [51]

The Clerk: Respondent's Exhibits G and H.

(The documents above referred to were marked Respondent's Exhibits G and H for identification.)

(The documents heretofore marked for identification as Respondent's Exhibits D, E, F, G and H were received in evidence.)

Mr. Malone: Your Honor, the Respondent will stipulate that any pencil markings appearing on these original documents may be disregarded as not material to the information that is contained therein.

Mr. Hall: We will so stipulate that they shall be disregarded. Is that acceptable?

Mr. Malone: Yes.

\* \* \*

(Witness excused.)

Mr. Hall: I will call Mr. Althouse.

### JACK ALTHOUSE

a witness called by and in behalf of the Petitioner herein, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: My name is Jack Althouse, A-l-t-h-o-u-s-e. My address is 1700 Highland Oak Drive, Arcadia, California. [52]

The Clerk: Thank you.

### Direct Examination

By Mr. Hall:

Q. What is your occupation, Mr. Althouse?

A. I am assistant to the president of Schalk Chemical Company.

Q. For how long have you been employed by Schalk Chemical Company?

A. For ten years, on March 16, 1958, I believe, it was.

(Testimony of Jack Althouse.)

Q. What are your duties as assistant to the president of Schalk Chemical Company?

A. As assistant to the president, and under his supervision, I have administrative control of the company. My responsibilities include all management functions.

Q. What, in general, is the nature of Schalk Chemical Company's business?

A. Schalk Chemical Company manufactures and distributes nationally a line of associated paint products and home repair products.

Q. What type of outlets in general are there for Schalk's products?

A. Primarily paint stores, hardware stores, department stores and chain stores.

Q. How many offices and plants does Schalk have? [53]

A. We have two.

Q. Where are they located?

A. One in Los Angeles, California, and one in Chicago, Illinois.

Q. How long have those plants existed?

A. The present plant in Chicago, I think Schalk moved into that one in '46, but Schalk has had an eastern office since the early 1920's.

Q. And the Los Angeles office?

A. There has been a Los Angeles office since the inception of the company, the corporation, in 1903.

Q. Now, what is the function of the Los Angeles office and plant?

A. The Los Angeles office is the main office of



(Testimony of Jack Althouse.)

the Schalk Chemical Company. It carries on the credit procedures, bookkeeping records and so forth.

In addition, it manufactures products, invoices them and services the United States from a north-south line through Denver on west.

Q. What functions are performed in the Chicago office and plant?

A. The Chicago office and plant manufactures products, invoices and services accounts from a north-south line from Denver east.

Q. Is most of Schalk Chemical's manufacturing done [54] in Los Angeles or Chicago?

A. Considerably more of it is done in Chicago.

Q. What ratio is done in Chicago, as compared to Los Angeles?

A. About 80 per cent is done in Chicago, about 20 per cent here in Los Angeles.

Q. Now, referring specifically——

Mr. Gardner: Might I inquire as to what year or years that we are talking about; is that the present business set-up, or was this the business set-up when you took over, or in 1950?

A. For the past ten years at least, a rough ratio of sales between east and west has been about 80 per cent Chicago, 20 per cent West Coast.

Mr. Hall: Thank you, Mr. Gardner.

Q. (By Mr. Hall): Referring specifically to the commencement of the year 1948, what products were then being produced and marketed by Schalk?

A. You would like the names of them?

(Testimony of Jack Althouse.)

Q. Yes. A. Prior to 1948?

Q. Well, at the beginning of the year 1948, what were they producing and marketing?

A. They were producing Hydro Pura, [55] Savabrush, Double X, Waxoff, Crack Filler, Wood Putty, Plaster Pencil and Spot Remover.

Q. That is a total of how many products?

A. That is a total of eight products, and they were available in 16 sizes.

Q. There were 16 assorted sizes?

A. Of the eight products; yes, sir.

Q. As to each of those products that you have named, when was each put on the market for the first time by Schalk?

A. Hydro Pura, 1903; Savabrush, 1920; Double X, 1924; Waxoff, 1932; Crack Filler, 1937; Wood Putty, 1940; Plaster Pencil in 1946, and Spot Remover in 1947.

Q. Now, does Schalk today produce those products? A. Yes.

Q. Have any changes been made in those products since the beginning of 1948?

A. Yes; several changes have been made.

Q. What changes have been made, Mr. Althouse, in general?

A. Several formula changes to improve the products, make them more saleable and several packaging changes.

Q. Several package—

A. Packaging changes, varying colors, varying sizes, that sort of thing. [56]

(Testimony of Jack Althouse.)

Q. How many products in total does Schalk produce and market today?

A. Schalk has 17 products today, in 41 assorted sizes.

Q. In other words, nine products as I understand it, have been added to the Schalk line since the beginning of the year 1948?

A. That is correct.

Q. Would you state chronologically the years in which each of those nine products have been added to the Schalk line?

A. Tile Cement was added in 1948; Patch Paste in 1950; Tile Paste in 1952; Liquid Savabrush in 1953; Liquid Waxoff in 1954; 1956 we added three products, Surex Paint Remover, X-It Paint Remover, and Do-X; 1957 S-14 Spackling Compound.

Q. From your experience with Schalk, how long does it take customarily to develop and market a new product of the type produced by Schalk?

A. From the time we present the idea, to a chemist, and go on through the art work, package design, formula, and so forth, approximately a year, until the product is actually on the market.

Mr. Gardner: I didn't get the time.

The Witness: Approximately one year. [57]

Mr. Gardner: Thank you, sir.

The Witness: Yes.

Mr. Hall: I have a document to be marked as Petitioner's Exhibit 13 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 13 for identification.)

(Testimony of Jack Althouse.)

Q. (By Mr. Hall): Mr. Althouse, I hand you a document which I will refer to as Petitioner's Exhibit 13 for identification, and ask you if you recognize that document? A. Yes, I do.

Q. What is it?

A. This is a copy of the Schalk Chemical Company dealer's price list for the year 1947, latter part of the year of 1947.

Q. Was that taken from the books and records of Schalk Chemical? A. Yes, sir, it is.

Mr. Gardner: May I ask a question regarding this document?

Does this document purport to contain all of the products manufactured by Schalk at this time?

The Witness: With one exception, these are paint and hardware items. One product, Hydro Pura has been, for [58] many years, a grocery store item, and it is therefore not listed on that price list.

Mr. Gardner: Now, as I understand it, this contains all of the products that they have at this time?

The Witness: In 1947.

Mr. Gardner: In 1947?

The Witness: Yes, sir, with the exception of Hydro Pura.

Mr. Gardner: With the exception of Hydro Pura?

The Witness: Yes.

Mr. Hall: That document is dated November 1, 1947, Mr. Gardner.

(Testimony of Jack Althouse.)

I offer this as Petitioner's Exhibit 13.

The Court: Admitted.

Mr. Gardner: No objection.

(The document heretofore marked for identification as Petitioner's Exhibit No. 13 was received in evidence.)

Mr. Hall: Mr. Clerk, will you mark that as Petitioner's Exhibit 14 for identification?

The Clerk: Petitioner's Exhibit 14 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 14 for identification.) [59]

Q. (By Mr. Hall): Mr. Althouse, I hand you a document which has been marked Petitioner's Exhibit 14 for identification, and ask you if you recognize that document?      A. I do.

Q. What is it?

A. This is the dealer's price list of Schalk Chemical Company for the year 1958.

Mr. Gardner: If the Court please, I would object to the introduction of this on the basis that this is much too remote to connect with any of the issues in this case. We are concerned here with 1950, 1951, not 1958.

Mr. Hall: Your Honor, much of the material that we have gone up to this point, is preliminary to further testimony, and Mr. Althouse has testified

(Testimony of Jack Althouse.)

as to when each of these products was introduced by Schalk.

And to complete the picture, I offer this as preliminary to later discussion of the problems they had as to products and so forth.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 14 was received in evidence.)

Mr. Hall: Just to clarify, your Honor, what Mr. Gardner asked about— [60]

Q. (By Mr. Hall): Mr. Althouse, neither Exhibit 13 nor Exhibit 14 lists or pictures Hydro Pura. Would you explain why that is?

A. All of the products listed on both the 1947 dealer price list and the 1958 dealer's price list are the associated paint products, and the home repair products that we have talked about earlier. They are sold through the paint stores, the hardware stores, department stores and chain stores.

Hydro Pura, on the other hand, has been for many years a grocery store item, and not sold by our own salesmen, but by grocery brokers.

The Court: What is Hydro Pura?

The Witness: It is a wall cleaner, similar, to compete with Spick and Span, Soilax, and that type of product.

Q. (By Mr. Hall): Years ago it was?

A. Years ago it was a water softener when it first came on the market.

(Testimony of Jack Althouse.)

Q. Now, Mr. Althouse, referring to Exhibit 13, which was the prior exhibit, price list, and to the prices that are shown on that exhibit, for how many years have those prices been in effect prior to November 1, 1947, [61] which is the date that shows on that exhibit?

Mr. Gardner: If the Court please, I don't think this is the proper witness to get that information from. He was not even with the company until 1948.

Mr. Hall: But, Mr. Gardner, it is available from the records of the company, and this gentleman has full management control of the company, as assistant to the president.

The Court: The witness may answer.

The Witness: The prices for the products in the respective sizes as they are indicated on the sheet, had never been changed from the particular year in which each product was introduced to the market.

In other words, there is no particular year for, like, say that it would cover the whole thing; because Double X, from '24 for instance, Waxoff from '32, Crack Filler from '37, Wood Putty from '40, Plaster Pencil from '46, Spot Remover from '47.

Q. (By Mr. Hall): So that the prices shown on Exhibit 13 were the prices set at the time?

A. At which they were introduced.

Q. At the time the product was put on the market; is that correct?      A. Yes. [62]

Q. Subsequent to the date of Exhibit 13, were those prices changed at any time?

A. Yes, they were.

(Testimony of Jack Althouse.)

Q. When were the prices first increased?

A. The prices were first increased in February of 1948.

Q. And what was the nature of the increase; I don't mean to go through each item, but approximately what was it?

A. The prices were raised on all products except Savabrush and Double X. They were raised approximately 20 percent.

Q. Have there been any subsequent price increases?           A. Yes.

Q. When were they?

A. There was an additional price increase in August and September of 1951. There was an additional increase in January of 1956, and there was another increase in January of 1957.

In each case, the increase was not necessarily across the board, but it approximated ten percent, 10 to 12 percent.

Q. Now, at the time of the—at the date of Petitioner's Exhibit 13, which is November 1, 1957, what trade discounts were allowed by Schalk Chemical Company? [63]

A. The Schalk trade discount was  $33\frac{1}{3}$  percent, and 25 percent, which is a complete net discount of 50 percent.

Q. How did that discount compare with discounts allowed by other companies or competitors in this particular field?

A. It was less discount than competitive products.



(Testimony of Jack Althouse.)

Q. Now, subsequent to the year 1948, has Schalk made any changes in the trade discounts under which it allows?       A. Yes, we have.

Q. What changes have been made?

A. The trade discount was increased from the 33 $\frac{1}{3}$  and 25 percent, to 40 percent and 25 percent, which gives a net complete discount of 55 percent.

Q. Now, what is Schalk Chemical Company's practice with respect to accounting for the amount of sales contributed each year by each of its products?

A. Each month we tabulate the case sales on each product for that month, on each size of each product for that month. By the same token, and at the same time, we also tabulate the dollar sales for the month period.

Then at the end of any given period, at the end of a year, for instance, it is a simple matter to multiply the number of cases sold of each size of each product, times the net billing price for that product, and arrive at what [64] percentage of the total that was accounted for by the particular product.

Q. Was such a tabulation made for the year 1957?       A. It was.

Q. With respect to the nine products which you testified have been added to the Schalk line since the beginning of the year 1948, what part of the gross sales of Schalk in 1957 were generated by those nine products?

A. From a dollar standpoint, the nine products

(Testimony of Jack Althouse.)

added since 1948 accounted for \$407,159.46 of the 1950 sales—1957 sales, pardon me, of \$476,627.45.

This means that the nine products added since '48 accounted for 53.2 percent of the 1957 sales volume.

Mr. Hall: You may examine.

### Cross-Examination

By Mr. Gardner:

Q. Mr. Althouse, I believe you testified that you were, have been an assistant to the president of Schalk for approximately ten years?

A. No, no, sir, I did not.

Q. What did you state, sir?

A. I have been an employee of Schalk since 1948. I have been assistant to the president, I believe, since 1954.

Q. 1954? [65] A. Yes, sir.

Q. What were your duties when you were first employed by Schalk?

A. I started with Schalk as a salesman.

Q. As a salesman? A. Yes, sir.

Q. And that was in the year 1948; is that correct, sir? A. Yes, sir.

Q. And who employed you?

A. I believe I was hired by Mr. Herman.

Q. Mr. Herman? A. Yes, sir.

Q. Did you know Mr. Farman prior to the time you were employed?

(Testimony of Jack Althouse.)

A. I had met Mr. Farman, I believe, on just one occasion prior to my employment.

Q. I see. Did you know Mrs. Farman?

A. I had met Mrs. Farman on one occasion prior to my employment.

Q. Did you know either of the daughters, that is Patricia or Evelyn?

A. I knew neither of them.

Q. You knew neither?           A. No. [66]

Q. You are not related in any way?

A. No.

Q. To the Farmans, or——           A. No, sir.

Q. Now, the paint products that were manufactured by the company prior to 1948, I believe you stated—was that correct, sir?           A. Yes, sir.

Q. You are still manufacturing those products, I take it; is that correct?

A. Yes, that is correct.

Q. And I believe you stated that it takes one year to prepare a product for market; is that right?           A. Yes, I did say so.

Q. What process do you go through in determining whether or not a product will be acceptable, whether or not you should manufacture a product?

A. Well, most of our ideas for products come from the trade, itself, from our own salesmen, or from our basic suppliers who are always looking for ways and means of distributing their basic products and selling them.

Once the idea has been more or less proved out through talking to the trade, and finding out what

(Testimony of Jack Althouse.)

competition is, and so forth, then it is turned over to our chemists who start working with these various supplies of basic [67] materials on a formula. Once the formula has been tentatively approved, then it is normally marketed.

A paint item, for instance, we might have the painters in a given area, or in several areas, try the product and give us their opinions. Many times from this type of work we find that the product is in need of some improving, and we go back to the laboratory.

Once we think we have the product all set to go, then it is a question of arriving at a package design, art work for the package, cataloging pages, trade advertising, consumer advertising, and actually getting the product on the market.

Q. Do you use any research agency to determine whether or not the sale of this item will be successful?  
A. A research agency as such, no.

Q. You do your own research in that respect?

A. Yes, we do; that is right.

Q. I take it—— A. That is right.

Q. Is there such a research agency available?

A. Oh, yes, there are several.

Q. Several?

A. There are several agencies available; very expensive, however.

Q. Let me ask you, sir, you stated that you did [68] develop nine products during the period of '48 to '57, which were successful; now, did you develop any products which were not successful?

(Testimony of Jack Althouse.)

A. If from develop you mean did any products actually go onto the market, that were not successful, that answer would be no.

Q. Now, prior to putting them on the market, you have sort of a little test that you make, you send the product around to the ultimate user, or something, is that what you do?

A. Well, that could be one form, yes. We might do some sampling with our various accounts, but more likely we would have a sales test in a limited area to see what the market acceptance was.

Q. Did you have any failures resulting from the disappointment in the sales test?

A. No, I don't believe we did.

Q. In other words, you were 100 percent successful in everything you did from '48 to '58; is that right?

A. Well, success, Mr. Gardner, is a relative thing. Some of the products we did much better on than we did on others. I think in every case we set a certain goal for the product. We surely don't reach that goal in every instance.

Q. But in any event, during this period of time [69] you had no products that you sought to sell that is, you got so far as making test of sales that were not successful; is that right?

A. We had no products that we withdrew from the market because sales fell below a break-even point.

Q. Now, at what point did you withdraw, or did you ever have any products that you worked on

(Testimony of Jack Althouse.)

that you had to discard; could you tell me about that?

A. The only product per se, no, we had one size of one product that because of the nature of the product wasn't successful in a tube, and it was necessary that we withdraw the tube size of the product from the market. The product, itself, is still very much on the market.

Q. I see. There was no product as such that you looked into with the idea of putting it on the market that you did not carry through and eventually put on the market, constituting one of these nine?

A. Mr. Gardner, I haven't said that, sir. We often have ideas of our own, or from our salesmen for products that we turn over to the lab, and as a matter of fact, we have innumerable products right now that are still in the lab and have never been brought out for one reason or another.

What I have attempted to say is that any product that has a period on the market during the years we have [70] been talking about is still on the market, and the sales are still, warrant its staying on the market.

Q. I see. I am trying to determine just how much experimentation you did in order to come up with nine saleable items.

Now, these are not the only items that you experimented on, are they?      A. No, my, no.

Q. You spend considerable time on others?

A. By all means.

Q. You are not always successful, are you?

(Testimony of Jack Althouse.)

A. By all means not.

The Court: I think you testified that some of the, that some 50 percent or 53 percent of the sales in 1957 were attributable to the so-called new products?

The Witness: Yes, sir, I did.

The Court: Now, some of those new products were simply the old products in different form, were they not?

The Witness: No, sir, that wouldn't be true. Some of the new products bore names of the old products, because of the fact that the years had been in our favor, in establishing these products with the trade.

However, I assume you are referring to liquid Savabrush, for instance, as opposed to powder Savabrush.

The Court: Did liquid Savabrush in your judgment, to [71] any extent supplant sales that you might otherwise have had of the powdered Savabrush?

The Witness: To a great extent, yes.

The Court: It did supplant it?

The Witness: It is an entirely different market, your Honor, and—

The Court: If liquid Savabrush had not been available, would you have had greater sales of the powdered Savabrush?

The Witness: We would have had less sales of powdered Savabrush.

(Testimony of Jack Althouse.)

The Court: You mean less than you in fact had of the powdered Savabrush?

The Witness: Yes, yes.

Mr. Gardner: There is just one thing—

The Court: It is an interesting statement; I would be glad to have your explanation.

The Witness: All right, I will try to give it.

Mr. Hall: I was going to ask that, your Honor.

The Witness: Yes, I will try to give it.

There are many accounts in the country, chain store accounts for instance, with the Grant, Firestone, J. J. Newberry, also many large paint and hardware accounts, who for one reason or another did not previously handle the Schalk line; Savabrush, for instance, up until a few years ago was a ten cent item, and many of these stores— [72] you can imagine the amount of volume to have a ten cent item in order to end up with any sales volume at the end of the year.

When, however, Schalk Chemical came out with items like liquid Savabrush with a higher list value, many of these accounts took on the Schalk line as such, and in so taking on the line carried with the old products like Savabrush and Waxoff.

Q. (By Mr. Gardner): At the same time weren't you attempting to get into the hardware stores more and more, too; don't you have a sales force out?

A. By all means, Mr. Gardner; yes, sir.

Q. Don't they contact these hardware stores?

A. Yes, sir.



(Testimony of Jack Althouse.)

Q. Isn't it a gradual process of contact and contact and then eventually getting the account; doesn't that have something to do with it?

A. Yes, sir.

Q. I mean, your salesmen, themselves?

A. Yes, sir.

Q. Weren't you putting on more and more effort through these years to get more accounts?

A. More than, more effort than what, Mr. Gardner?

Q. Don't you have a continual, make a continual [73] effort to get more accounts?

A. By all means, yes, sir. We make a continual effort to better our salesmen, better train them, and——

Q. How large was your sales force in 1948, sir?

A. I don't recall, Mr. Gardner.

Q. How large was your sales force now?

A. We have approximately 15 salesmen.

Q. Fifteen salesmen. The figures that you quoted I noticed you obtained those figures from some sort of memorandum in your pocket?

A. Yes, sir.

Q. Who prepared that memorandum?

A. The memorandum that I have was prepared by me, Mr. Gardner.

Q. That was prepared by you. Are you an accountant, sir?

A. No, I am not.

Q. Where did you get the figures that you put on that memorandum?

(Testimony of Jack Althouse.)

A. Those figures came off the case sales report for the year 1957.

Q. What is a case sales report?

A. It is a breakdown of all cases sold during the year of each individual size of each individual product.

Q. And who added them up? [74]

A. That was done by our bookkeeper in the office.

Q. That was done by somebody else?

A. Yes.

Q. And is there any possibility that you could have made an error in your figures?

A. These figures, Mr. Gardner, can be reconciled, and have been by the total of each individual size of each individual product in relation to the total sales for the years, period.

Q. But you haven't done that, have you?

A. No, sir; I haven't done that.

Q. You just took the figures that were given you, and you can't say whether or not they are accurate, can you?      A. I guess not, sir.

Mr. Gardner: No further questions.

### Redirect Examination

By Mr. Hall:

Q. The products that were produced by Schalk Chemical Company prior to 1948, Mr. Althouse, were any of those in liquid form?

A. No. [75]

(Testimony of Jack Althouse.)

The Court: You may proceed.

Mr. Hall: Your Honor, may I recall Mr. Althouse for a couple of questions on redirect examination? Government Counsel has no objection.

The Court: You may.

Mr. Hall: Mr. Althouse.

### JACK ALTHOUSE

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

#### Redirect Examination

(Continued)

By Mr. Hall:

Q. Mr. Althouse, from 1949 to 1954 what position did you hold in Schalk Chemical Company?

A. I was manager, eastern division.

Q. By manager, what do you mean?

A. I was responsible administratively for all the activities of the Chicago factory, plant and sales operation.

Q. That office covered what territory nationally?

A. That covers the eastern United States from roughly the north and south line through Denver, Colorado.

Q. Mr. Althouse, yesterday you testified that or concerning a case sales summary which Schalk makes monthly, semi-annually and annually.

Do you have with you summaries of that nature?

A. Yes; I did. [78]

Q. What years, Mr. Althouse?

(Testimony of Jack Althouse.)

A. These are the semi-annual and annual summaries from 1954 up through the first six months of 1958.

Q. What is the purpose of making a sales summary?

A. It served two purposes really.

One, it provides one of the checks and balances in making sure that errors don't occur in sales figures.

Two, it's really the only accurate comparison we have on sales for a given product, a given size of a given product, for a given period of time. I say it's the only accurate record we have. Dollar totals can be misleading by reason of the fact that if you have a price increase, for instance, your billing on a particular product would automatically be higher, and if you considered only the dollar value, you might imagine that you have a modest increase in sales for this particular product when it's not only conceivable but likely that you might have a decrease or sales might be static.

Q. I see.

Thank you, Mr. Althouse.

#### Recross-Examination

By Mr. Gardner:

Q. By the way, Mr. Althouse, how old are you?

A. I'm 39.

Q. You are 39, and ten years ago you were 29, is [79] that correct?

A. That's right.

(Testimony of Jack Althouse.)

Q. Twenty-nine at the time you were assistant manager?

A. I was made manager, eastern division, in 1949. I guess I would be 30 years old.

Mr. Gardner: Thank you, sir.

Redirect Examination

(Continued)

By Mr. Hall:

Q. What was your formal education, Mr. Althouse?

A. I have a Bachelor of Science Degree in Business Administration.

Mr. Hall: Thank you.

Mr. Gardner: No further questions.

Mr. Hall: May this witness be excused?

The Court: He may be excused.

(Witness excused.)

Mr. Hall: Call Mr. Farman.

GERALD I. FARMAN

a witness called by and in behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: You may be seated, please.

Will you state your name and address for the record, please? [80]

The Witness: G. I. Farman, F-a-r-m-a-n, 205 W. Orange Grove Avenue, Sierra Madre.

(Testimony of Gerald I. Farman.)

Direct Examination

By Mr. Hall:

Q. Mr. Farman, are you president of Schalk Chemical?           A. I am.

Q. Are you also one of the individual Petitioners in this proceeding?           A. I am.

Q. Will you speak up, Mr. Farman, for the purpose of the Reporter?           A. I will.

Q. How long have you been president of the Schalk Chemical Company?

A. Since January 15, 1948.

Q. Mrs. Farman is also an individual Petitioner in this proceeding, is that correct?

A. That is correct.

Q. When were you and Mrs. Farman married?

A. August 14, 1931.

Q. Approximately how old was Mrs. Farman's son, Mr. Horace O. Smith, Jr., at that time?

A. I believe about 17.

Q. Did Mr. Smith live with you and Mrs. Farman after your marriage? [81]           A. Yes.

Q. For how long after?

A. Until he got married.

Q. You recall when that was?

A. No; I do not. I don't recall the date.

Q. After Mr. Smith's marriage, where did he and his wife live?

A. They lived in the guest house that was adjoining up.

Q. In other words, they lived with you?

(Testimony of Gerald I. Farman.)

A. On the property, yes.

Q. For how long did they live with you, approximately?

A. Approximately two years, I would say.

Q. Mr. Farman, what formal education did Mr. Smith have?

A. He, as I recall it, he went through grade school, public school, and then he went to private, went in a private school. He didn't graduate from high school. He went in a private school.

Q. Mr. Farman, do you know when Mr. Smith started to work for Schalk Chemical Company?

A. As I remember, it was 1936. I haven't that date.

Q. Prior to going to work for Schalk Chemical Company, what business experience did Mr. Smith have, if any? [82]

A. He worked for a Ford agency in Pasadena for approximately six months, as a salesman.

Q. Did he have any other prior business experience?

A. Not to my knowledge.

Q. As far as you know?

A. Not to my knowledge.

Q. During the years 1940 to 1945, Mr. Farman, what was your occupation?

A. I was a chief of supply of the Pacific Division, Army Engineers, U. S. Army.

Q. What were your duties as chief of supply?

A. The awarding of contracts, the contracts for building the airports, the ordnance bases, all work that is done by the Army Engineers in connection

(Testimony of Gerald I. Farman.)

with war effort, various types of camps, directing dredging of harbors for the Navy. It does not answer it?

Q. You refer to the Pacific Division. What was the Pacific Division?

A. The Pacific Division included the 11 western states, the south Pacific, central Pacific, and north Pacific theaters of operation.

Q. Mr. Farman, while you were acting in that capacity as chief of supply for the Corps of Engineers, did you have at any time, have any occasion to contact Schalk on the behalf of the Corps of Engineers? [83]

A. It was my duty to obtain supplies from various sources of various types of supplies; on two different occasions that I specifically recall at this moment I wanted to purchase double X for bleaching hospital floors at Modesto and was turned down.

I tried through Mr. Smith direct and later through Mrs. Farman to get these supplies, explaining that I would issue a priority for the raw material.

On another occasion I wanted a water softener for Marysville. And Marysville is built on the lava bed there, and the water is very, very hard, and I wanted hydro pura for water softener and offered them a large order with a priority, and I was turned down. That order was later given to Borax, and I asked Borax to contact Schalk because they had automatic packaging equipment and, get them to



(Testimony of Gerald I. Farman.)

take over as a subcontractor, so that I could get this supply expedited.

Q. As to each of those, I want to ask you some questions, Mr. Farman.

You mentioned an order for Double X. When, approximately, was that?

A. As I recall, it was 1943.

Q. Who did you talk to and talk about it?

A. And I talked to Mr. Lieben and Mr. Smith directly about it. [84]

Q. Who was Mr. Lieben?

A. Mr. Lieben was the manager at that time of this office here, I believe.

Q. You also mentioned Hydropura, an order for Hydropura. When was that, Mr. Farman?

A. I don't recall the exact date. It was either 1942 or '43, I believe, that we billed Marysville.

Q. Who did you talk to on that occasion?

A. Mr. Smith and Mr. Lieben.

Q. Did you personally talk to anybody at Schalk about packaging material for Borax?

A. Yes; I went with Mrs. Farman down to the office and asked. Mrs. Farman said why can't we package this, this Borax material for them, and I was present when it was turned down again. [85]

\* \* \*

Q. (By Mr. Hall): Were there any other occasions on which you contacted Schalk for materials for use in some war effort with which you were connected?

(Testimony of Gerald I. Farman.)

A. During 1942 and 1943 and 1944 we were building crash boats over at San Quentin, and one other place in McNeil Island in the northwest, and we wanted a caulking material for these crash boats and I tried to buy wood putty from Schalk for this.

I believe, as a matter of record, I did write to Schalk: I have not a copy of this, incidentally; I wrote to Schalk and asked to buy 10,000 pounds of wood putty for caulking; San Quentin was turned down.

Q. Mr. Farman, as chief of supply for the Pacific Division of the Corps of Engineers, what was your authority with respect to the issuance of priorities?

A. I had full authority to issue a priority on every, on all supplies and every project that was built where the contractor supplied the materials.

Q. Were the priorities issued by your office?

A. They were issued by my office.

Q. As I understand your testimony, these orders that [86] you testified to were refused by Schalk?

A. They were.

Q. What did Mr. Smith say to you with regard to these orders, if anything?

A. I recall Mr. Lieben's answer much more clearly, that if we supplied the Government with the supplies, why, they may not, it may interfere with their customer relations.

In fact, they thought their customers should supply the Government direct at a profit, which I ob-

(Testimony of Gerald I. Farman.)

jected to. I complained to Mr. Lieben at that time again that I would issue a priority for the supplies, and it was our general practice to issue approximately ten per cent overage, and he would have the benefit of that ten per cent in raw materials for customer relations, again our customer accounts.

Q. Mr. Farman, as chief of supply and concerning these orders, were those the only orders which you could have directed to Schalk at that time?

A. Absolutely not.

I happened to be in a position that we were using various types of materials that Schalk was making and especially in camouflaging oil storage plants and down the coast. The aircraft factories were all camouflaged under our offices, and we needed materials for cleaning our spray guns and other materials that Schalk were manufacturing, in dire need of them. [87]

Q. Mr. Farman, was this attitude on the part of the management of Schalk a matter of concern to you and Mrs. Farman and the rest of the family?

A. It surely was, very much.

Q. Did it become a matter of controversy between you?           A. It did.

Q. Then in the period from 1942 to '45 what other policies or actions of Schalk's management, if any, caused you and Mrs. Farman and the rest of the family to become concerned about the business?

A. Well, Mr. Smith would not co-operate in any

(Testimony of Gerald I. Farman.)

way with the other stockholders of Schalk. He wouldn't take advice.

During that period—I don't want to get off from the subject here—during that period there was a terrific demand from the trade, meaning retailers and wholesalers alike, for any product they could possibly get ahold of to sell.

Prior to 1940 obviously Schalk's products had reached a peak and had started sliding due to the fact that they were outmoded.

We suggested that it was imperative that the company go into a research program and develop new products that were easier to use and not so commonly known in formula [88] wise, and so forth.

Any product development and research of the markets were turned down.

I can't recall offhand all of the various things that came up exactly.

We did, Mrs. Farman presented, and in my presence, and I presented new products, and they were turned down, completely, by management, including Mr. Lieben and Mr. Smith.

One of the products specifically was liquid starch. It had never been a liquid starch on the market, and we came in with a formula for liquid starch.

Mr. Gardner: May I interrupt just a moment, please?

The witness is continually referring to "we." I would like to have that clarified as to who he means by this term.

(Testimony of Gerald I. Farman.)

The Witness: In this instance Mrs. Farman and I. I will use that from now on.

Mr. Gardner: And on the prior instances that we made suggestions which were received?

The Witness: That is, I will clarify that by saying Mrs. Marlow; that is Mr. Smith's sister. Mrs. Baker, Mrs. Smith's sister, a stockholder, and Mrs. Farman and myself. I will be very clear.

Mr. Gardner: Thank you.

The Witness: DDT was another product that we thought was new, it was new, and on the market we thought, Mrs. Farman [8] and I specifically, mentioned this as an insecticide, it wasn't on the market.

Mr. Gardner: May I inquire again, sir, what year are we speaking about?

The Witness: We are speaking of the years from 1942 to 1945.

Mr. Gardner: 1942 to 1945 you suggested DDT?

The Witness: That is a question.

Q. (By Mr. Hall): Mr. Farman, what production methods were used by Schalk in those years?

A. The first time I saw the factory in Chicago was in October or September or October, 1945. They were filling packages by hand, using a little scope, graduated scope, filling it, gluing the packages and putting them in a container to hold.

Q. Did they have any automatic equipment?

A. They had no automatic equipment. They had some or one piece of semi-automatic equipment.

Q. Did you recommend to management that they

(Testimony of Gerald I. Farman.)

install automatic equipment?           A. I did.

Q. During that period was the advertising of Schalk handled through any agency?

A. It was handled through during the period of 1942 [90] to 1945, I believe it was Honig-Cooper. It was handled through Dr. Hal Stephens, who was vice president of Erwin Wasey Company, and then that was absorbed by Honig-Cooper. I can't tell you the exact date, but it was all handled by their same agency.

Q. Were you and Mrs. Farman satisfied with the particular advertising picture of Schalk?

A. We definitely were not.

That was again a main point of controversy because of the money spent on advertising without any follow up.

Q. What advertising does Schalk employ?

A. At this time?

Q. What did it employ at that time?

A. They used full pages in the Saturday Evening Post, full pages in Better Homes and Gardens, American Home, Good Housekeeping, and many other leading magazines.

Q. Your objection, then, was that the costs were out of line?

A. The costs were prohibitive.

Q. You mentioned Mr. Lieben being manager. Was the fact that Mr. Lieben was manager a matter of controversy?

A. Very much so. Mr. Lieben was the dominating influence in the Schalk Company. Mr. Lieben's at-

(Testimony of Gerald I. Farman.)

titude towards Mrs. Farman was not timely. [91]

Mr. Gardner: If the Court please, I would like to object to the testimony of this witness insofar as it relates to Mrs. Farman and the other members of the family. It hasn't been shown there have been any foundation here that this witness is associated with the corporation at this time. Now anything he has to state regarding the members of the family is strictly hearsay, and I object very strongly to any testimony by this witness relating to how the members of the family felt or any testimony in connection with that at all.

What he felt, that's all right, but there has been no foundation to show that he was connected either with this corporation at this time.

The Court: He may state what he observed.

Mr. Hall: In his presence.

The Court: In his presence, but he may not—

The Witness: I'll definitely state that Mr. Lieben was very insulting to Mrs. Farman in my presence and caused the family to be very concerned over his position as manager, and later when he was promoted to general manager of the company.

Further, I was told by Mr. Fulmer, the manager in Chicago—

Mr. Gardner: I object to this now. This is something that is hearsay that is coming in here. [92]

The Witness: Hearsay when it's told me direct?

Mr. Gardner: Let's not have him testify to it, I think then.

(Testimony of Gerald I. Farman.)

The Court: The witness may not say what someone else told him.

Mr. Hall: Your Honor, at a time as Mr. Gardner states that there has been no foundation that he was connected with the corporation, or would that ruling apply to after the time he was connected with the corporation?

The Court: I haven't made any such general ruling.

My ruling is simply limited to hearsay statements.

I suggest it might be more helpful if Counsel put direct questions to the witness rather than letting him wander at large.

Mr. Hall: Thank you.

Mr. Gardner: Could we also have dates? I never get the date, the time Mrs. Farman was insulted by Mr. Lieben in his presence. I don't know whether that was prior to the period we're talking to or subsequent.

Q. (By Mr. Hall): When did that occur, Mr. Farman?           A. In 1945 and 1946.

Q. When did you leave the position as chief of supply of the Corps of Engineers?

A. In August, 1945. I took annual leave. [93]

Q. The war had ended by that time; was that the reason you left that job?

A. It was the reason that I took annual leave, that my work had slacked down and I had not had a day off from August, 1940.



(Testimony of Gerald I. Farman.)

Q. What did you immediately do upon taking annual leave?

A. I talked with Bob and Mrs. Farman.

The Court: Who is Bob?

The Witness: Pardon me, Mr. Smith. I'm sorry.

I talked with Mrs. Farman and Mr. Smith in regard to their problems. They were the various problems that had been in controversy.

Q. (By Mr. Hall): When did that conversation take place?

A. In the latter part of August and the 1st of September, 1955.

I made certain suggestions.

Q. Just a minute. Do you know a Mr. Henry O. Wackerbarth? A. I do.

Q. Who is Mr. Wackerbarth?

A. An attorney here in Los Angeles.

Q. What connection did he have with Schalk Chemical Company? [94]

A. He was a secretary and a director for the company and the attorney for the company.

Q. At what period of time, Mr. Farman?

A. From 1931 through 1947.

Q. When were you elected a director of Schalk Chemical, if you recall.

It has been stipulated, your Honor, that it was in 1945.

Mr. Gardner: I believe that was it.

Q. (By Mr. Hall): Do you know, Mr. Wackerbarth's signature? A. I do.

Q. Would you be able to recognize it?

(Testimony of Gerald I. Farman.)

A. Yes; I would.

Mr. Hall: Mr. Clerk, will you mark this Petitioner's Exhibit 15 for identification, please?

The Clerk: Exhibit 15 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 15 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you a document which has been marked Petitioner's Exhibit 15 for identification, and I ask if that document bears the signature of Mr. Wackerbarth? [95]

A. It does.

Q. Will you describe what that document is?

A. Well, it mentioned—

Q. No, no, Mr. Farman. I just wanted you—

A. It's a letter addressed to Mr. Stanley Guthrie, Mrs. Farman's attorney.

Q. What is the date of it, Mr. Farman?

A. Dated September 20, 1945, in which it sets forth the various controversies.

Q. That is enough. And was Mr. Wackerbarth Mr. Smith's attorney?      A. He was.

Q. Mr. Farman, Petitioner's Exhibit 15 for identification is addressed to Mr. Stanley W. Guthrie. Who was Mr. Guthrie?

A. Mr. Guthrie was Mrs. Farman's attorney.

Mr. Hall: I offer this as Petitioner's Exhibit 15.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Petitioner's Exhibit 15.

(Testimony of Gerald I. Farman.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 15 was received in evidence.)

Mr. Hall: Your Honor, may I place that in front of the witness for a moment? [96]

Q. (By Mr. Hall): Mr. Farman, Petitioner's Exhibit 15 refers to an arrangement involving the setting up of an executive committee for the company.

Was such a committee set up?

A. It was.

Q. How was it accomplished?

A. The bylaws of the corporation were amended to allow for an executive committee.

Q. At the time the bylaws were amended to set up the executive committee, were there any changes made in the directors of the company?

A. I was made a director at that time.

Q. Anyone else that you recall?

A. Mr. Guthrie was accepted with a position of director.

Q. Were you elected an officer at that time?

A. I was not.

Q. Were you later elected an officer?

A. Later in 1946 I was elected a vice president.

Q. Did the executive committee prove to be a satisfactory arrangement?

A. It did not. It was completely ignored by Mr. Smith, and it was not a workable plan.

(Testimony of Gerald I. Farman.)

Q. Why wasn't it workable? [97]

A. Because Mr. Smith didn't recognize the executive committee. It was only a name. It was a name only and he did not recognize it.

Q. What vote was required of the members?

A. Unanimous vote on all subjects of any consequence, all major subjects, at least.

Q. Who were the members appointed to the executive committee?

A. Mrs. Farman, Mr. Smith and myself.

Q. How long did Mr. Guthrie stay on the board of directors?

A. Approximately a year, to my knowledge. I wouldn't say a year.

Q. Did he resign at that time?

A. He was asked by Mr. Smith to resign.

Q. In what year was this?

A. In 1947.

Q. I believe it was in 1946, was it not?

A. It could have been. I'm sorry.

Q. He was asked by Mr. Smith to resign?

A. He was.

Q. Mr. Guthrie had accepted the privilege of being the director on what condition?

A. On one condition only, that he would go in as an arbitrator. [98]

Q. At a subsequent time after his resignation as director or was that vacancy filled?

A. It was filled by Mr. Smith, filled by a Mr. Roush.

Q. Who was Mr. Roush?

(Testimony of Gerald I. Farman.)

A. Mr. Roush was the auditor for the firm at that time.

Q. Do you recall when Mr. Roush was elected a director?

A. He was elected a director, I believe, in March, 1947, when I was fired.

Q. Was there an annual shareholders' meeting in 1947?           A. There was.

Q. Do you recall approximately the time that that meeting was?

A. I believe it was either January or February. I can't recall the exact date.

Q. It was at that meeting that Mr. Roush was elected director?

A. That was the meeting when he was elected.

Q. Was there an annual directors' meeting following the annual stockholders' meeting?

A. There was, yes.

Q. What took place at that meeting, Mr. Farman?

A. The office of vice president was the office that I held, as vice president was, no—— [99]

Q. Was what?

A. Well, it was eliminated. I guess that is the term for that. The executive committee was dispensed with, and the bylaws amended to take care of both the office of vice president and the executive committee.

Q. By take care, what do you mean?

A. To abolish these two positions.

Q. Were you present at that meeting?

(Testimony of Gerald I. Farman.)

A. I was.

Q. Did you object to that action?

A. I did.

Q. Did Mrs. Farman object? A. She did.

Q. But you remained a director, is that correct?

A. I was director because I represented my two, the two girls, Mrs. Marlow and Mrs. Baker.

Q. By represented, what do you mean, Mr. Farman?

A. Well, I was their representative on the board of directors for the company, at their request. Mr. Smith and his board couldn't eliminate that position because of my representing them.

Q. Was that because of the provisions of the trust?

A. That's because of the provision for the trust, of the trust.

Q. Now, as I understand it, approximately December, [100] 1945, until early in 1947 you were employed by Schalk Chemical? A. I was.

Q. During that period of employment, what were your duties with Schalk Chemical?

A. I was an expediter of raw materials from September, '45, until all through that period.

Also, in 1946, entered into the study and means of recommendations on modern production, buying equipment, and that sort of thing.

Q. And now what was your first job that you undertook for Schalk?

A. I understood to get materials for Schalk.

Q. What did you do in that regard first?

(Testimony of Gerald I. Farman.)

A. I went to Chicago with Mr. Smith and found that—

Q. When was that?

A. That was in September, 1945.

Q. What were the conditions at the Chicago plant at that time?

A. They were entirely out of materials. The employees were not doing anything because of not having any raw materials to formulate and package.

Q. What did you do by going to Chicago?

A. I immediately took all of the orders that were, they had on hand, which was a tremendous amount of orders, [101] and advised them to find out, ascertain how much materials would be needed to fill these back orders that dated back as far as June, 1945.

After making the analysis, I then had a quick picture of the amount of materials that would be required to operate the business.

Q. Was management taking any action at that time to secure materials?

A. Their version to me was they couldn't get them.

Q. Were you behind—strike that.

Were you hired in a sense to obtain materials; that was the purpose of your being?

A. That was the purpose of my employment.

Q. What items were they short of exactly, Mr. Farman?

A. They were out of trisodium phosphate, which

(Testimony of Gerald I. Farman.)

was the bulk of their raw material requirements. They were entirely out of sodium perborate, another product that was essential to the formulation of the products.

In fact, they were entirely out of all materials that were required.

Q. Trisodium phosphate, would you explain which of the products that were then produced by Schalk, which of those products was it essential to have trisodium phosphate for?

A. Their leading product and the largest profits maker [102] is Double X, and it's essential to Double X, also essential to Savabrush and Waxoff.

Q. The other item was what, that you specifically mentioned?

A. Sodium Perborate I specifically mentioned, which is very essential to Double X. There were two other products.

Q. The company was also manufacturing wood putty at that time? A. Wood putty.

Q. What is the essential ingredient in wood putty?

A. Molding plaster, which is a gypsum product, was essential and it was in short supply.

Q. At the time you reviewed the orders, did you ascertain from whom Schalk Chemical was obtaining these two, let's say, two essential raw materials?

A. I did.

Q. Who were they obtaining those from?

A. They were obtaining trisodium phosphate—



(Testimony of Gerald I. Farman.)

that's misstated—they had a contract with General Chemical for trisodium phosphate.

They were not getting any supply at all on that contract. They had a contract with DuPont Corporation for perborate, and perborate was essentially, it was on priority and was so important to the war effort they were unable to obtain that, and they had a contract with United [103] States Gypsum Company for molding plaster, which was not being recognized by U. S. Gypsum.

Q. After you reviewed the orders and determined what was needed, what did you do?

A. I asked permission to go to New York to see General Chemical Company, and also I wanted to be at New York to see the American Agricultural Company, which is a big manufacturer of trisodium phosphate and so forth.

Q. Did you go to New York?

A. I went to New York and contacted these people.

Q. Did you contact U. S. Gypsum?

A. I did.

Q. Did you contact General Chemical?

A. I did.

Q. Did you obtain any supplies from them?

A. From neither one of them.

Q. Were you able to obtain supplies?

A. I was able to obtain supplies, yes.

Q. Approximately when were you able to arrange to have these raw materials shipped to Schalk?

(Testimony of Gerald I. Farman.)

A. I have two carloads of trisodium phosphate rolling from an independent source in October, 1945, and November, 1945.

Q. Did you set up any general sources of supply for those raw materials other than from United States Gypsum or [104] general chemical?

A. I set up a new source of supply right in Joliet, Illinois, known as the Lawson Chemical Company, who agreed to supply us trisodium phosphate, supply all our needs of trisodium phosphate, though it was in short supply.

Q. Do you obtain that raw material from them, that organization today?           A. We do.

Q. What about molding plaster?

A. I went to a new source of supply, the Circle T Corporation, and obtained their willingness to supply us our full requirement of molding plaster, and they fulfilled that promise.

Q. How soon after you embarked upon this job of obtaining materials did the plant in Chicago go back to full production?

A. To my best recollection, we were back in full production in February, 1946.

Q. In addition to raw materials, were there any other essential supplies that were short?

A. Very difficult to obtain shipping cases, the cartons, the packages that we packaged in. Any paper products were in short supply, and I had to find sources for that.

Q. Was Schalk in short supply itself? [105]

(Testimony of Gerald I. Farman.)

A. Definitely out of most of all shipping cases, most cartons.

Q. Were you able to obtain those supplies for Schalk?

A. I was. In fact, I obtained a carload of cartons in Chicago and shipped them to Los Angeles for their production.

\* \* \*

Q. (By Mr. Hall): Now, Mr. Farman, did you have anything to do with the development of new products for Schalk Chemical Company in 1946?

A. I obtained the two products and recommended their—

Q. You were looking into the subject of the product of Schalk Chemical Company at that time?

A. Mrs. Farman and I recommended approximately 18 or 20 products that would fit into Schalk Chemical Company. Some of them—

Q. The products that were then being manufactured by Schalk were what, Mr. Farman? [106]

A. Were Savabrush, Double X, Waxoff, Wood Putty and Crack Filler.

Q. In your opinion were those products meeting the market demand at that time?

A. Market study that I personally made in 1945 in Southern California indicated that the products were fast becoming obsolete.

Q. Why was that, Mr. Farman?

A. Because new products were being introduced to the market that were easier to use, faster and more effective in the form of liquid products.

(Testimony of Gerald I. Farman.)

Q. Were all of the products that were then being produced in powdered form, is that correct?

A. All products in 1945 were produced in powdered form.

Q. Was there a product added to the line in 1946?

A. Plaster Pencil was added in 1946.

Q. What did you have to do with adding that product to Schalk Chemical line?

A. I was in Boston working with Mr. White, Edmund White, one of Schalk's salesmen at that time, and we called on a customer over in Cambridge, and I found a plaster stick called plaster stick, made by the Leonard Company in Des Moines, Iowa, and bought one of them and discussed possibility of Schalk's going into that and another product [107] and eventually we did produce that product.

Q. That, you mentioned that product to management?      A. I did.

Q. What was management's reaction?

A. They were reluctant to go into it, I believe, for at least one reason.

They couldn't manufacture it themselves. They didn't have the facilities.

Q. Was it manufactured by Schalk when it was put on the market?

A. It was not. It was manufactured by the Lake Chemical Company of Chicago.

Q. Was that pursuant to a contract between Schalk and the Lake Company?

(Testimony of Gerald I. Farman.)

A. We contracted with them to make this product.

Q. Who arranged that contract?

A. I did personally.

Q. Were there any products added to the Schalk line in 1947?

A. During 1946 I also found another product on the market for cleaning grease off from wall paper, and I think—I picked up that package and recommended that we also go into that product.

It was produced, actually got onto the market in 1947. [108]

Q. You stated that some other products were recommended but refused, Mr. Farman. Would you give some illustrations?

A. We recommended a liquid brush cleaner.

Mr. Gardner: If the Court please, once again I would like to have the witness instructed to state who is this we.

The Witness: I'm sorry.

These recommendations that I will mention were made by Mrs. Farman and Mrs. Marlow, some by Mrs. Marlow, some by Mrs. Baker, and some by myself. I cannot segregate them.

We recommended a liquid brush cleaner which was very essential because liquid brush cleaners were coming on the market and powder brush cleaners were commonly, are fast becoming flow movers.

Q. (By Mr. Hall): Were there any on the market at that time, Mr. Farman?

(Testimony of Gerald I. Farman.)

A. Liquid brush cleaners, I knew of one at that time.

Q. Does Schalk produce a liquid brush cleaner today?      A. We do.

Q. How many competitors do you have today?

A. Approximately 20. [109]

Q. What other products did you recommend?

A. Recommended a paint and varnish remover.

Q. That was a liquid?      A. A liquid.

Q. That was in 1946?      A. During 1946.

Q. Were there any products of that nature on the market at that time?

A. Yes; there were possibly three or four. There was only one important one that had started to break into the market, and they were not, it wasn't common enough to be an obstacle.

Q. You recall when Schalk put that product on the market?

A. We put a paint and varnish remover, liquid paint and varnish remover, two liquid paint and varnish removers on the market in 19——

Q. Approximately?

A. Approximately 1956.

Q. How many competitors were there at that time that were producing the same product?

A. Probably 35 or 40.

Q. You mentioned liquid starch in your prior testimony. Was that also recommended in 1946?

A. That was recommended in either 1945 or '46 by [110] Mrs. Farman in my presence.

Q. Was there any liquid starch product on the

(Testimony of Gerald I. Farman.)

market at that time?           A. There were not.

Q. What is the situation today?

A. It is liquid starch made by several companies today, but the main one here on the coast is a thing called Vano Corporation in San Francisco, who put out the first liquid starch, I believe.

The Court: You have mentioned from time to time various recommendations that Mrs. Farman made either alone or in conjunction with you or recommendations that two of Mrs. Farman's sisters have made. Did you outline briefly just what experience they had had in either the fabrication of such products or of their knowledge of market conditions that would warrant the assumption that such products could possibly profitably be distributed?

The Witness: Mrs. Marlow and Mrs. Farman, as housewives, were interested in finding products that were, would make their housework easier and make the home a better place in which to live, so they were natural as housewives.

Mrs. Farman, your Honor, was an employee of the company at this time, and the duties that were outlined in her employment was the study of the market, of market conditions, of the study of and research on new products. [111]

She had as an adviser Dr. Diehl here in Los Angeles and was paying Dr. Diehl personally out of her own pocket.

Does that answer?

Q. (By Mr. Hall): Now, during the period that

(Testimony of Gerald I. Farman.)

you were employed by Schalk Chemical Company, in addition to the matters you have testified to before, were there any other matters that the—became of concern to you and to Mrs. Farman and the rest of the family in a matter of controversy with Mr. Smith and his management?

A. There were many. I will try and——

Q. Start with the first one.

A. I mentioned before Mr. Lieben's appointment as general manager in 1944, the refusal to modernize production, refusal to spend any money on research.

Mr. Gardner: If the Court please, is this witness testifying as of the time when he was associated with the corporation?

The Witness: I am.

Mr. Gardner: Or is this hearsay?

The Witness: No; I am testifying from September, 1945, through 1946.

Mr. Gardner: Thank you, sir.

Q. (By Mr. Hall): Mr. Farman, did you do anything about production [112] methods in 1946?

A. I did.

Q. What did you do?

A. I recommended the purchase of two pieces of equipment that were, that made it possible for us to produce the products that were sold in 1946.

Otherwise, we wouldn't have been able to have hit our sales peak under the old methods.

Q. Were there any other matters that came up during that year that were a matter of controversy?



(Testimony of Gerald I. Farman.)

A. One specific point I would like to mention is the matter of expansion of shop, the matter of new products that were so necessary for the continuation of Schalk as a company.

We were virtually out of business because of lack of raw materials. From there we went into production—— [113]

\* \* \*

Q. (By Mr. Hall): Did you make any recommendation in 1946 with reference to the expansion of the Chicago plant? A. I did.

Q. What was that recommendation?

A. The Philco Building became available during 1946 at a price that Mrs. Farman and I, who inspected the building, felt we could pay, and recommended it to Mr. Smith.

Q. What were the conditions at the Chicago plant? Would you describe the conditions at the Chicago plant which required expansion?

A. Our space was not adequate to expand our facility, our products, and build new products.

Q. In what respect, Mr. Farman? [115]

A. The square footage of floor space is the main thing.

Q. Was it overcrowded?

A. It was overcrowded.

Q. In what respect was it overcrowded?

A. Our raw materials were being purchased in carload lots, which required a lot of space for storage, and we obtained new equipment to pieces of new equipment which took up space.

(Testimony of Gerald I. Farman.)

Our business during 1946 was, the volume was far greater than any other year in the history of the company, and naturally it required a terrific lot of space to manufacture these to meet this production.

Q. Was there any consideration of the liquid products that were contemplated at that time in connection with the facilities?

A. The liquid products had all been turned down by Mr. Smith and Mr. Lieben.

Q. In connection with your recommendation that the facilities be expanded, did you have a plan or an arrangement whereby you could purchase other properties or acquire other property? [116]

A. The Philco Building was one block north of our present plant, and it was on the market at \$118,000. It was adequate for expansion, probably would have taken care of the production up to now.

Q. As an officer of the company, what money, to your knowledge, was spent for advertising in 1946?

A. Approximately \$97,000.

Q. In 1945?

A. Approximately the same.

Q. 1947?

A. Approximately the same.

Q. Was that a matter of controversy, Mr. Farman?

A. It was a very definite, was a matter of controversy, not between Mrs. Farman and Mr. Smith, but between his two sisters, Mrs. Marlow and Mrs. Baker, and Mrs. Farman, and myself, and Mr. Smith.

Q. Who was Mr. Jacobs?

(Testimony of Gerald I. Farman.)

A. Mr. Jacobs was a chemist that I recommended be employed to produce new products for Schalk Chemical Company.

Q. When did you recommend that Mr. Jacobs be employed?

A. It was during 1946, in the early part of '46.

Q. Was he employed?           A. He was.

Q. How long did he remain employed by Schalk Chemical? [117]

A. He was fired in March, 1947, my best recollection.

Q. Did you object to the firing of Mr. Jacobs?

A. I did.

Q. Who was he fired by?           A. Mr. Smith.

Q. As a director and an officer of Schalk, did you study the financial statements of Schalk in the years 1945, '46 and '47?           A. I did.

Q. What did you notice with regard to costs of goods sold?

A. The ratio of cost of material to the cost of goods sold was fast increasing, which meant that, in other words, the raw materials costs were going up very rapidly.

Q. Was labor going up also?

A. Labor was also going up.

Q. Did you make any recommendation because of that fact?

A. I first recommended that we raise, increase our list price.

Q. When was that recommendation made?

(Testimony of Gerald I. Farman.)

A. That was first recommended in the latter part of 1945.

Q. Who did you make that recommendation to?

A. To Mr. Smith, and it was then recommended by the [118] executive.

Q. Were the prices increased?

A. They were not.

Q. In '46 or '47?           A. They were not.

Q. Was any equipment disposed of by the company during the period '46 and early part of '47?

A. Mr. Smith gave an automobile to one of the salesmen that quit because of his being retired, because of his age.

Q. By gave, what do you mean?

Mr. Gardner: May I inquire further, how did you know that, Mr. Smith——

The Witness: I was there, sir.

Mr. Gardner: Very good, sir.

The Witness: I objected very seriously because automobiles were in short supply, very impossible to buy, and I thought that the company ought to keep the car.

He proceeded to tell me that it's none of my business.

Q. (By Mr. Hall): During the period '45, '46, did Schalk Chemical Company sell products to chain stores?           A. They did not.

Q. Did you make any recommendation? [119]

A. I did.

Q. In that regard?

(Testimony of Gerald I. Farman.)

A. I recommended we expand our market by selling to chain stores.

Q. By chain stores, what do you mean?

A. Newberry, Kress, Grant, chains known as five and ten cent stores.

Q. Does Schalk sell to those outlets?

A. We have about four outlets at the present, J. J. Newberry and W. T. Grant, we have Sears, that we didn't have at that time, and we have several small five and ten cents stores that we sell direct to.

Q. You mentioned, Mr. Farman, that in terms of sales 1946 was a high year. In your opinion, why did this occur?

A. We were shipping in 1946 orders that were dated in June, 1945. From June on through '45. We were unable to ship them because of no raw materials. Actually 1946 sales are not sales that or orders that were received in 1946; they are 1945 and '46.

Q. What type of account was Schalk serving to a large extent in 1946, I mean, what type of customer accounts?

A. They were serving paint stores and hardware, wholesalers, some retail stores.

Q. Were there any other type of accounts that were peculiar to that period? [120]

A. During the period 19—latter part of '45 during my employment with Schalk, in '46, the retail stores and wholesalers alike could sell anything they could buy. They naturally would like to or pre-

(Testimony of Gerald I. Farman.)

ferred selling products that they were geared to sell, but they bought Schalk products because if they could get them, they at least ordered them, and many other products, but Schalk products specifically that we're talking about, just to have something to sell.

Their shelves were not bare, but in bad shape. All merchants were.

Q. Do you have an illustration of such an account?

A. One illustration I can give you, several, one of them here in town was Goff Industries.

Q. What is Goff Industries?

A. They are an electrical wholesaler.

Q. Do you sell to Goff Industries?

A. No, sir.

Q. When was the last time that you sold to them? A. 1946.

Q. Now, reverting, Mr. Farman, to the executive committee arrangement that you testified was set up in September of 1945, I believe, and continued until at least in power until some time in 1947, how quickly after it was set up did it show signs of not being workable? [121]

A. My answer would be immediately, within 30 days.

Q. Why, what was the occasion at that time that indicated that it was not workable?

A. I don't specifically recall.

There were so many occasions that I don't recall

(Testimony of Gerald I. Farman.)

the first occasion other than that Mr. Smith proceeded to ignore the committee and——

Mr. Gardner: If the Court please, that is a conclusion, and I regret very much the necessity of making objections continuously to this type of testimony.

Mr. Hall: The objection is well taken.

Q. (By Mr. Hall): The executive committee was an arrangement to settle the disputes, so to speak, was it not?

A. That was the purpose of the executive committee.

The Court: Did you have meetings of the committee?

The Witness: Yes.

The Court: How often did it meet?

The Witness: We met every day. Officially we set it up to meet once a week as official body, but we were together every day. We were working together.

The Court: Were any minutes kept of the meetings?

The Witness: Yes, they were, by me.

Q. (By Mr. Hall): In 1945 and '46, were any other plans suggested [122] for the settlement of the dispute that existed at that time?

A. Yes; several suggestions offered. I don't recall the first one now, Mr. Hall. There were many suggestions offered.

Q. Do you recall any of them? What other

(Testimony of Gerald I. Farman.)

methods were proposed to settle this dispute with Mr. Smith?

A. Mr. Smith proposed that he would get out for a given amount of money.

Q. What did he want to get out?

A. He asked, his first request was, he said he would get out for \$25,000 as president of the company. He later retracted and made it \$50,000.

Q. When was this, Mr. Farman?

A. It was during 1946.

Q. Were there any other suggestions as to the manner of settling it, by employment contracts or otherwise?

A. We included this time all of the family, Mrs. Marlow, Mr. Marlow, Mrs. Baker, Mr. Baker, Mrs. Farman and myself, offered him an eight-year contract to act in a capacity that he was qualified to act and with a minimum wage.

Mr. Gardner: If the Court please, that is another conclusion, acting in the capacity he was qualified to act.

That is the opinion of this witness, and I think the record should show clearly that that is merely his own [123] opinion.

Mr. Hall: Yes.

Q. (By Mr. Hall): Will you state exactly what the proposal was, Mr. Farman, if you recall?

A. We proposed an eight-year employment contract with a minimum salary. I can't tell you what the salary was.

Q. A guaranteed minimum salary?



(Testimony of Gerald I. Farman.)

A. Guaranteed minimum salary for eight years.

Q. As part of that proposal, what was the proposal with respect to the supervisor of the trust?

A. That he would resign as supervisor in favor of Mrs. Farman.

Q. What was proposed with regard to his job with the company, I mean, he was to be employed for eight years?

A. In a capacity, he was to remain in a capacity of, oh, may I word it this way: We were going to set up a workable executive committee and not pin down to the unanimous vote of all, the majority vote, and he was to serve on this executive committee and as one of the directors of the company.

Q. In the early part of 1947, I believe you stated your employment you said with Schalk Chemical Company. Following that situation, what steps were taken to settle [124] the dispute still existing?

A. In 1947?

Q. 1947. A. Oh, we started suit.

Q. By we, who do you mean?

A. The family started suit. I believe it was Mr. and Mrs.—no, Mrs. Baker and Mrs. Marlow, and, I believe, they were the ones that started the suit.

Q. Was that discussed by the family, and with whom?

A. It was discussed with Mrs. Farman and all members of the family, including Mrs. Marlow's husband and Mrs. Baker's husband.

Q. The suit was filed, it is part of the record that is attached to the stipulation, what else oc-

(Testimony of Gerald I. Farman.)

occurred in 1947 with regard to settlement of the dispute?

A. Well, due to the fact that the suit had been started, negotiations continued for the settlement.

Mr. Gardner: If the Court please, may I interrupt?

I don't believe that this witness is qualified to testify regarding the results of this suit or what went on during the suit. He is not a party to that suit.

Q. (By Mr. Hall): Did you have anything to do with the filing of that suit?

A. I did. [125]

Q. What did you have to do with it?

A. I was in Mr. Guthrie's office at all times, when there were any controversy or any negotiations, or at any time that plans were laid prior to the suit and during the suit.

Mr. Gardner: If the Court please, I still object to the testimony of this witness relating to that suit on the grounds that he is not a party to that suit. He is nothing but a spectator.

Q. (By Mr. Hall): In 1947, Mr. Farman, were meetings held with Mr. Smith in an attempt to negotiate a settlement?      A. They were.

Q. Of the dispute?      A. They were.

Q. Where were those meetings held?

A. In Mr. Guthrie's office, in the Pacific Mutual Building.

Q. Who was usually present at those meetings?

A. Mrs. Farman and I were always present at

(Testimony of Gerald I. Farman.)

the meetings. Mrs. Marlow and Mrs. Baker were there at most of them.

Q. Was Mr. Smith present?

A. Mr. Smith was always present, yes.

Q. Was Mr. Wackerbarth, his attorney, [126] present?

A. On one or two occasions, only, that I know of.

Mr. Hall: Mr. Clerk, will you mark that as Petitioner's Exhibit 16, for identification?

The Clerk: Exhibit 16 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 16 for identification.)

Q. (By Mr. Hall): Mr. Farman, were you present at a meeting on January 15, 1948, at Mr. Guthrie's office? A. I was.

Q. Who else was present at that meeting?

A. Mr. and Mrs. Marlow, Mr. and Mrs. Baker, Mr. Smith and Mrs. Farman, Mr. Guthrie, of course.

Q. Was Mr. Wackerbarth present?

A. I can't say. I don't recall.

Q. Was an agreement signed at that meeting?

A. Yes, sir.

Q. Did you personally see the parties to the agreement sign it at that meeting?

A. I did.

Q. I hand you a document which has been marked Petitioner's Exhibit 16 for identification, and ask you if that is the agreement which you refer to? A. This is the agreement. [127]

(Testimony of Gerald I. Farman.)

Q. In your prior testimony? Is that the agreement?      A. This is the agreement.

Q. Would you describe what it is, that is, who the parties are and the date of it?

A. The parties to the agreement are Mrs. Farman, Evelyn Smith Marlow, Patricia Farman Baker, and Horace O. Smith, Jr.

Q. The date of that agreement?

A. The date of the agreement is January 15, 1948.

Mr. Hall: I offer this in evidence as Petitioner's Exhibit 16, your Honor.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 16 was received in evidence.)

Q. (By Mr. Hall): That is what we may from time to time refer to as the settlement agreement. Now, Mr. Farman, did you participate in most, if not all, of the negotiations leading to the exhibit which is Petitioner's Exhibit 16?      A. I did.

Mr. Gardner: Your Honor, I object to that question. That calls for a conclusion of this witness as to whether or not he participated in all of them. He is not a party [128] to this agreement. His name isn't on that agreement any place, and I object to that type of a question from this witness. He doesn't know.

(Testimony of Gerald I. Farman.)

The Court: Will the Reporter read the question?

(Record read.)

The Court: I will let the witness answer that.

The Witness: I did.

Q. (By Mr. Hall): Over what period of time did those negotiations take place, over what period of time? A. Leading up to this?

Q. Yes. A. I would say from all of 1947.

Q. Now, during that period and prior thereto and up to the time of that agreement, did you make further studies and inquiries as to Schalk's financial condition?

A. During the time that we negotiated the agreement? Will you give me the question again?

Q. Yes. Were you keeping in touch as a director of Schalk with the financial condition of the company? A. I certainly was.

Q. In these negotiations were you authorized to represent anyone?

A. I was authorized to represent Mrs. Marlow and Mrs. Baker. [129]

Q. Were you authorized to represent Mrs. Farman? A. I was.

Q. As a representative and individually in 1947 and the beginning of 1948, Mr. Farman, what was your opinion or let me state it this way, did you have any opinion as to the condition and future prospects of Schalk? A. I did.

Q. What was your opinion?

(Testimony of Gerald I. Farman.)

A. My opinion was that Schalk was very much on the downgrade.

In fact, it was, had a limited life, because of no future products development.

Q. On what did you base that opinion, Mr. Farman; could you tell us the items?

A. Well, I can tell you the items, yes.

The trend at that time was towards more modern products, products that were easier to use, faster and more convenient to use.

I base my statement that Schalk was fast becoming a firm that would not continue in business on the fact—a known fact—that DuPont used a ten-year yardstick as to the length of life of a product from the time it's first marketed until it hits its peak.

Schalk's products, some of their products were much, had gone far beyond the ten years without any [130] improvement in formula.

The sales analysis that I personally made indicated that the products had already started downhill in 1938 and '39, and had it not been for the war, Schalk would have been out of business, but the war, as I stated before, created a demand for products.

Mr. Gardner: If the Court please, this is just a series of conclusions and opinions. I dislike to interject this same objection, but it does get rather tiresome, your Honor.

The Court: He was asking for an opinion, and his opinion may well be relevant, and I will let the answer stand.

(Testimony of Gerald I. Farman.)

Mr. Hall: I was asking what the facts were.

Mr. Gardner: He is bringing in other conclusions, now in answering his opinion.

Mr. Hall: That was his opinion, Mr. Gardner, as to the products, and he was stating the basis for his opinion.

Mr. Gardner: Very well.

Q. (By Mr. Hall): What was the financial condition of Schalk at the end of 1947?

A. Schalk lost approximately \$32,000 in 1947.

Q. Was that one of the factors which you based your opinion on? [131]

A. Absolutely.

Q. Mr. Farman, I hand you Petitioner's Exhibit 9, which is the audit report of Schalk Chemical Company for the year ended December 31, 1947, and I direct your attention to the balance sheet as of December 31, 1947, and the first item under current liabilities, which is a note payable to the Union Bank.

Do you know when that note was payable, was due, Mr. Farman?

A. It was due in September, 1947. I believe I'm right on that date.

It was due in 1947, the latter part.

Mr. Hall: May I have this marked?

The Clerk: Exhibit 17 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 17 for identification.)

Q. (By Mr. Hall): Mr. Farman, are you familiar with the signature of Horace O. Smith, Jr.?

(Testimony of Gerald I. Farman.)

A. I am.

Q. I hand you a document which has been marked Petitioner's Exhibit 17 for identification, and ask you if that document bears Mr. Smith's signature?

A. It does. [132]

Q. Would you describe what Petitioner's Exhibit 17 for identification is?

A. This is a note signed by Schalk Chemical Company, Mr. Horace O. Smith, Jr., and Henry Wackerbarth, in the amount of \$2,500.

Q. I believe this is \$20,000.

A. \$20,000. It was dated October 29, 1947.

Q. That note shows the due date of January 29, 1948?

A. That's correct.

Mr. Hall: I offer this in evidence as Petitioner's Exhibit 17.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 17 was received in evidence.)

Q. (By Mr. Hall): Is that the note that is referred to in the first item under current liabilities?

A. That is this note here, yes. [133]

\* \* \*

Q. (By Mr. Hall): Mr. Farman, prior to the noon recess you had stated your opinion in 1947 and beginning of 1948 as to the future of Schalk, and you were stating the factors upon which you base your opinion.



(Testimony of Gerald I. Farman.)

I do not recall at what point where you left off, but would you like to state the factors again, please, or continue stating them?

A. The fact that we, that the Schalk Chemical Company lost money in 1947.

Q. Would you continue, Mr. Farman? You were speaking about the year 1947.

A. The company suffered a major loss in 1947 of \$32,158. The fact that they owed money to the bank, the fact that their case was pretty much depleted, led me to believe that the company could not suffer another major loss in 1948. In fact, I was, I firmly believed that the company would not survive the end of the trust, the conclusion of the trust.

Q. And that belief was based upon a continuation of the management that was then in control, is that correct?      A. That is true.

Q. What was your opinion, in your opinion what was [135] the reason Schalk Chemical Company having a low working capital at that time?

A. In 1946 the company paid out a very large dividend in the amount of \$54,000 or \$55,000, and it was because of that that our working fund was, the company's working fund was as low as it was.

Q. Also was your opinion based on any trends within the company itself? By trends, I mean any trends as to products or as to profit and loss over the years, sir?

A. In 1940 the company also, this was a post-war year, and the company also lost money.

Q. What was——

(Testimony of Gerald I. Farman.)

A. Then after the war it lost. Pardon me, you started to ask me a question?

Q. No, go ahead.

A. The trend in the late '30's that caused this loss of the product decline, and I felt that during the war it was the war economy that brought the products back and enjoyed the benefits of the profits we made during the war years, but again back in 1947 we found a pattern or what I felt was a pattern of another decline after the post-war years.

Q. Do you have any products specifically in mind?

A. I had, yes, that was why I was looking for this notebook, because I jotted down some figures.

I used two products here, Hydropura is one of them. [136] Back in 1922 the company sold \$270,244 worth of Hydropura. Back in 1931 the sale was \$14,363.

Now, the other product that I took, I just took two products, didn't want to go into this deeply, was the largest profit item that we had. It was a 75 list seller, Double X, and Double X—in other words, Double X was the leader in the line, and Double X in 1937 the sales were \$104,209, and in 1940, they had declined to \$78,000.

This decline was a lot due to the trend in the over-all picture—the over-all market.

For instance, in the field of Double X, Hydropura, or in the field of Double X the electric sanders had come into the picture and were a rental item.

(Testimony of Gerald I. Farman.)

Well, Double X was designed to take the varnish off from the floors. They could rent a sander, and in the opinion of practically a lot of the people the sander was an easier and quicker method of removing the varnish from the hardwood floors.

That trend——

Q. In the use of Double X, how long does it or what is the method that is applied?

A. The method is very hard to remove varnish with Double X. You have to have boiling water to start with, and you put the powder in the boiling water and mop it on the floor and get down and with a scrub brush or, in many instances, steel wool and remove the varnish, which is the [137] hard way to do it.

Q. In 1947, what trends outside of the company did you have in mind?      A. Well——

Q. Basis of your opinion?

A. That was one of them; the ease of application of all of our products, were very difficult, very hard to do. The Savabrush would require 48 to 60 hours to soften a hard paint brush. Liquid brush cleaners were coming on the market. They would soften a brush and clean a brush overnight.

The do-it-yourself trend was very definitely on its way, had a very good start, and our products—it was very essential that we tie it in with this do-it-yourself trend.

Q. In your opinion, did the prior management in any way tie into that trend?      A. They did not.

Q. What was the result of that failure to do so?

(Testimony of Gerald I. Farman.)

A. Competition came in very strongly and came in with products that were easy to use or easier to use, certainly, than our old fashioned methods of powdered products.

Q. Did inflation in any way affect your opinion?

A. It certainly did. We were definitely paying terrifically high prices and they were increasing, not yearly, [138] but monthly, and this inflation caused me to believe that if we were to survive, another reason if we were to survive, that we would have to increase our prices, our list prices, and we'd have to do something about competition by meeting the discounts allowed by competition, which we were not meeting.

Q. At that time Schalk was producing certain products which were allied to the paint industry, were they not?

A. They were. Their products were all associated.

Q. Associated paint products? A. Yes.

Q. Was there any dangers in that, Mr. Farman?

A. I felt definitely that we should diversify our products, and talked at length with management about diversifying into other fields. This was not an unusual thing. The other companies, similar companies, were diversifying as fast as they could in fields not directly associated in the paint industry.

The Court: When were these discussions?

The Witness: During 1947, is the date that I understood.

The Court: Did you have any discussions of this

(Testimony of Gerald I. Farman.)

character after the filing of the suit in April 11, 1947?

The Witness: We still continued to negotiate a settlement, sir. [139]

Q. (By Mr. Hall): And also Mr. and Mrs. Farman were directors of the company at that time.

What was the danger in being limited to the associated paint products field, in your opinion?

A. At that time there was some indication that the large, the major paint companies would produce their own products. That would definitely eliminate the sale of Schalk to these companies. They would sell their own brand names.

I'm speaking specifically of Pittsburgh Plate Glass, Sherman-Williams, and all of their associated companies.

There was a definite indication that they were going to do that, and some of them, some of the products were on the market at that time under their brand name.

Q. Did the dispute that was going on with Mr. Smith and the rest of the family, did that affect your opinion in any way?      A. It certainly did.

My purpose of continuing negotiations and trying to settle this thing was that I felt very definitely that the company couldn't survive under the conditions that were existing, the contention and so forth.

The Court: Was that point of view the same point of [140] view that you held at the time the suit was instituted?

(Testimony of Gerald I. Farman.)

A. Yes, sir. I felt that way when we instituted the suit.

The Court: Was there any evidence at that time of an adverse earnings picture?

The Witness: Oh, the adverse earnings were actually, I think, just started in March or April of 1947.

The Court: According to Exhibit 2, the suit was actually filed, the complaint was filed on April 11, 1947, and it is a rather lengthy document.

I would imagine that the determination to file this suit was arrived at at some point considerably earlier than April 11, 1947, was it not?

The Witness: I think it was, Judge, your Honor. I felt that, as many of them did, meaning the principals, stockholders, that it was necessary to do something or the company would be completely out. Nothing being done toward a new product type of thing as I mentioned this morning. Definitely something had to be done to remove the management and get the thing on a basis so that it would survive.

The Court: My questions are directed not so much towards the diversification of products, or the improvement of products, as they are towards the actual earnings picture of the company, and as I look at Exhibit H, the audit report [141] for 1946, there appears to have been a very favorable earnings picture for the year '46, the last full year before the filing of this suit.

The Witness: Yes.

(Testimony of Gerald I. Farman.)

The Court: And, therefore, rather puzzled am I by your statements about adverse earnings.

The Witness: May I—

The Court: You are sure there were adverse earnings in the year '47 but that was the year it was completed, a good many months after the determination to file the complaint in the suit? I would appreciate having any comments you can make.

The Witness: The only thing I made plain, first, the large earnings in 1946 may be attributed to, one, we were shipping orders received as far back as June, 1945. We were shipping those orders in '46.

Number two, we had been able to obtain by instigating and negotiating new contracts with suppliers to fill all of the orders we had on hand. The market at that time was the market, being in the trade, were clamoring for any type of product they could get to sell.

The people had the money to buy and products were, many many commodities were in short supply, and it was a very hard thing for the market, the trade, to find products to sell. They were selling shop products. There [142] were many companies selling Schalk products that didn't do it in '47.

Q. (By Mr. Hall): Also, Mr. Farman, my question was directed to your opinion as of the time of the settlement agreement, at which time there was a question of whether to proceed with the lawsuit or to settle it, and that was in early '48, and at that time you were aware of the lawsuit, is that correct?

A. Certainly was.

(Testimony of Gerald I. Farman.)

Q. You became president, you testified, on January 15, 1948.

Shortly after that did you make a survey of Schalk's accounts? A. I did.

Q. In what manner or procedure did you do that?

A. I covered the middle west. I travelled by automobile covering the middle west, the south, and the eastern seaboard, calling on all major accounts.

Q. For example, would you give an illustration of the accounts you called on?

A. I naturally covered the two major accounts in the United States, Sherman-Williams in Cleveland. That's their main office. Also Pittsburgh Plate Glass in Pittsburgh, Pa. But I covered such accounts as the wholesale hardware [143] accounts in Cleveland, Worthington Company, Bingham, Belknap down in Louisville.

The Court: At what time was this?

The Witness: In 1948 shortly after I became president.

The purpose of this was to make a survey of Schalk's position in the market and trend towards new products.

Mr. Gardner: If the Court please, I fail to see the materiality of his testimony as to what this witness did after the agreement in question was executed. He is now the president and all the acts that have taken place now, what he does now, I don't see has any relevancy on this case at all.

Mr. Hall: Your Honor, a survey was made



(Testimony of Gerald I. Farman.)

shortly afterwards, and I think the Petitioners are entitled to state their opinion as to the result of that survey, which is close enough to the key time to show some evidence as to why they moved as they did in 1948.

The Court: It rounds out the picture.

I will receive the evidence.

Q. (By Mr. Hall): Mr. Farman, how long did it take you to make this survey?

A. About seven weeks.

Q. How many accounts would you say you contacted, [144] roughly?

A. Roughly about 2,000 accounts.

Q. In your opinion, what was the attitude of Schalk's accounts at that time, as far as the Schalk line of products was concerned?

A. Will you reword that?

Q. In your opinion, what did you determine was the attitude in the industry towards Schalk at that time?

A. In this case I would like to be specific, very specific.

Belknap, who is the largest wholesale hardware in the world, Charlie Coble in the buyer department, specifically said, you're a nuisance.

Mr. Gardner: I object to that as hearsay.

The Court: Overruled.

Q. (By Mr. Hall): Continue, Mr. Farman.

A. He said, we like you. You're a small company, a good company, probably, but your products are

(Testimony of Gerald I. Farman.)

outdated. You are back in the horse and buggy days, and you are a nuisance account to us.

I had to inquire what a nuisance account was. I had never heard the expression before.

Pittsburgh Plate Glass invited me out when I went in by stating that we have asked the Schalk Chemical [145] Company to come over and see us, and they told us to come see them.

Sherwin-Williams—

Mr. Hall: All right.

Q. In your opinion, what was Schalk's standing in the industry at that time, at the time of this survey, in your opinion?

A. My opinion was it was a has been, that Schalk was a has been, if that is satisfactory. It had been a good company.

Q. In your opinion, was Schalk standing in the industry—what is Schalk's standing in the industry today, in your opinion?

A. Schalk has been a leader for several years. They have put out more products than any one company in the field, as evidenced by our—

Q. What do you mean by leader?

A. They are the largest manufacturer of home repair and associated paint products.

They are in two fields today. They are the largest manufacturer in a number of products.

The Court: Speaking of the number of products or the gross receipts or what?

The Witness: No, the number of products.

(Testimony of Gerald I. Farman.)

That's what I tried to qualify, Judge, I'm [146] sorry.

Q. (By Mr. Hall): Why is the number of products an important consideration?

A. The trend, in fact this is more than a trend today, it is necessary in today's markets, to cut for, the wholesaler to cut inventories to the bone, and to cut expenses.

Expenses have climbed to the point where it is very essential to cut them. It is preferable, and as borne out in our own operation for a company to buy as much as they can from one source. This is developing more and more as 1958 progresses.

Q. Since you became president of Schalk Chemical Company, Mr. Farman, what has been the dividend policy of the company?

A. We have not paid a dividend. I advised the stockholders when I went in as president that I wanted their permission to bury or plow back into the company as much as I possibly could earn for building a long-lasting substantial business.

To do that, it required a lot of money, required money to put new products on the market. We have introduced, I believe it was, brought out nine new products in the last ten years.

Q. Have you presently any negotiations going on for the acquisition of facilities in Chicago? [147]

A. We have. We have been over a period of years, since 1949, 1950, where we got back in volume, it was absolutely necessary to increase our facilities by new and larger buildings, and we have been ne-

(Testimony of Gerald I. Farman.)

gotiating for several years to find a cheaper location where we could or find a building—already built where we could produce new products that we have in many instances tested and are ready for the market but we are handicapped because of cramped facilities.

Mr. Hall: May I have Plaintiff's Exhibit 16.

Your Honor, excuse me just a moment.

Q. Mr. Farman, I hand you Plaintiff's Exhibit 16, which is, with permission of Counsel, I may call the settlement agreement, you have testified that there was a meeting on that date and that you were at that meeting and saw that document executed with that meeting. Were other papers executed on that date, within your recollection?

A. I wouldn't know without studying this. There were other, there were certain bases that were a part of this settlement agreement.

Q. We have in evidence as Plaintiff's Exhibit 4, Mr. Farman, a release dated January 15, 1948, signed by Mrs. Farman, Mrs. Marlow and Mrs. Baker in favor of Mr. Elmer J. Jensen. Would you state who Mr. Jensen was?

A. Mr. Jensen was Mr. Colyear, Mr. Colyear a former president of the company, manager I believe, and was a [148] director of Schalk during Mr. Jensen's or Mr. Colyear's reign as president.

Q. Did I understand you to say that Mr. Jensen was a manager of Schalk?

A. Of, I'm sorry, of Colyear Motor Sales.

Q. But he was a director of Schalk?

(Testimony of Gerald I. Farman.)

A. He was a director of Schalk.

The Clerk: Exhibit 18 for identification.

(The document above referred to was marked  
Petitioner's Exhibit No. 18 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you a document that has been marked Petitioner's Exhibit 18 for identification, and ask you if that document bears the signature of Mr. Horace O. Smith, Jr.?

A. It does.

Q. Would you describe that instrument, just the title of it and the date of it?

A. It's dated January 15, 1948, consent to cancellation of portion of dividend declared.

Mr. Hall: I offer this as Petitioner's Exhibit 18.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 18 was received in evidence.) [149]

The Clerk: Petitioner's Exhibit 18.

Mr. Hall: I am sorry, your Honor, I would like to have the witness have that agreement, please.

The Court: Exhibit 16?

Mr. Hall: Yes.

Q. (By Mr. Hall): Mr. Farman, you have in front of you the settlement agreement, which is Exhibit 16, and you have testified that negotiations leading to that agreement took place over several months' period, and I don't recall your testimony, so

(Testimony of Gerald I. Farman.)

I ask you the question again; where were the meetings held to discuss the settlement agreement?

A. At Mr. Guthrie's office in the Pacific Mutual Building.

Q. Did you attend all of those meetings?

A. I attended every meeting. My office was also adjoining there, and I attended every meeting.

Q. What proposals were made at those meetings by way of settlement of this entire problem?

A. By way of settlement the eight year agreement that we offered employment to Mr. Smith.

Q. This is in 1947, Mr. Farman?

A. That occurred in 1947. We offered employment to Mr. Smith on a contract of employment guaranteeing him eight years, that he remain on the board. [150]

Mr. Gardner: Might I inquire again as to who we are?

The Witness: The stockholders of the Schalk Chemical Company, Mrs. Farman, Mrs. Marlow and Mrs. Baker.

The Court: Were you taking an active part in the negotiations?

The Witness: Yes.

The Court: Were you representing Mrs. Farman's interest?

The Witness: Mrs. Farman and the two girls.

Mr. Hall: I think there was testimony to that effect, your Honor.

Q. (By Mr. Hall): Can you be more specific,

(Testimony of Gerald I. Farman.)

Mr. Farman, as to what the proposals were, let's say, from your side of the fence?

A. I definitely recall that we offered eight years, an eight year contract, to Mr. Smith, that he remain on the board as a director, that he remain an employee of the company and receive a salary for his services.

I recall that one very well, and it was turned down.

Q. Were there any other proposals?

A. There is no doubt of other proposals. I just haven't the key. There were many proposals. We offered everything we could to settle this without getting into a wrangle.

Q. What did Mr. Smith propose? [151]

A. Mr. Smith first said I'll get out if you'll pay me \$25,000.

Later he retracted it and made it \$50,000.

Q. When did he make that type of a proposal?

A. During the latter part of 1947.

Q. You say he retracted the offer to take \$25,000 and made it \$50,000?           A. Yes, sir.

The Court: What did you understand him to mean by saying I'll get out?

The Witness: I understood that he would——

The Court: Was there included within that offer, as you understood it, an offer to sell or dispose of his interest in the company, as well as to relinquish any hold that he had on management?

The Witness: Your Honor, the first proposal of \$25,000, as I understood it, was that he would resign

(Testimony of Gerald I. Farman.)

as president and relinquish his position as supervisor of the trust in favor of Mrs. Farman.

The second proposal I very definitely understood included his interest, his stock interest in the company.

Q. (By Mr. Hall): Did he at any time, Mr. Farman, offer to give you an option on his stock? By you, I mean the rest of the family? [152]

A. Yes, he did. I would like to go on record that we didn't want his stock. We, meaning Mrs. Farman and her two daughters, were not interested. I was a negotiator in this case, and they were not interested in buying his stock. In fact, they preferred not to buy his stock.

Q. What were they interested in?

A. They were interested in——

Mr. Gardner: If the Court please, I think the witness is to testify as to what he knows of his own knowledge. What they are interested in should be testified to by the people themselves, that is Mrs. Farman, Mrs. Baker and Mrs. Marlow.

The Court: I will let him testify because he represented them in these negotiations.

The Witness: The sole interest of Mrs. Marlow, Mrs. Baker and Mrs. Farman was to reach a peaceful conclusion wherein this business could be operated without fear of it going broke.

Q. (By Mr. Hall): Again I come back to the proposal from your side of the fence, Mr. Farman. What was proposed, either by you or by your attorney, Mr. Guthrie?



(Testimony of Gerald I. Farman.)

A. I'm afraid I'm a blank on it.

Q. Did the company have money at that time to make a settlement? [153]

A. Definitely. At that time, of course, it was always the intention, as far as clear understanding was concerned, that the company would pay Bob this money, but they were, there were many factors that entered into it.

Bob refused to begin with to accept the money from the company. I believe—well, that's an opinion.

Anyway, the idea and the general intent was that the company would pay Bob to relinquish his—

Q. Did you make any proposal in regard to that?

Mr. Gardner: I would like to move that the witness' last answer be stricken for this reason, that he stated it is always the intent of the company to assume this obligation or to take this obligation.

That is the very point we are in issue with right here.

Mr. Hall: May we have it read back?

Mr. Gardner: That is a conclusion that I do not think should be allowed to remain in the record.

Mr. Hall: I don't believe he said that, your Honor.

The Court: I think he did say it.

Mr. Hall: Did he? May we have it read back?

The Court: The Reporter will read it back.

(Record read.)

The Court: No foundation at all has been laid showing that there has been any corporate action

(Testimony of Gerald I. Farman.)

whatever to justify [154] the testimony of the witness that such was the intention of the company, and I will grant the Government's motion to strike.

Q. (By Mr. Hall): Again, Mr. Farman, I would like to ask you what was any or all of the proposals you made to Mr. Smith in counter to his proposal?

A. One of the proposals that we made was that we again institute an executive committee to operate Schalk Chemical Company as a body that was fair and could operate on a majority vote.

He refused that one.

Q. What other proposals were made in 1947?

A. I'm afraid I don't recall what proposals were made other than various plans. We proposed to pay him what he first asked, the \$25,000, to get out.

Q. By we, who do you mean?

A. The company, Mrs. Farman and her daughters agreed to that, and he changed his mind on that.

Q. He changed his mind on what, Mr. Farman?

A. On the \$25,000 to get out or to resign.

The Court: Did you ever make the offer? I thought he made the offer and it was withdrawn before you ever accepted it.

The Witness: Well, I believe that the time that it was, [155] that he made the offer, we said, well, we said——

The Court: If you had accepted it, there would have been a deal right then and there, would there?

The Witness: I'm afraid not.

Mr. Hall: Your Honor——

The Court: Did you accept?

(Testimony of Gerald I. Farman.)

The Witness: Yes, we were ready to accept.

Q. (By Mr. Hall): At the time of the acceptance of any offer, Mr. Smith had still not executed documents that took away his control, isn't that correct, Mr. Farman?

A. Yes, he was supervisor of the trust, which gave him absolute control over the company and its stock.

Q. Mr. Farman, in 1947, and, your Honor, this witness is having trouble remembering; I have evidence that shows some other facts——

The Court: Proceed.

Q. (By Mr. Hall): Is it not true, Mr. Farman, that in 1947 your proposals to settle with Mr. Smith and the family proposal was that the corporation would pay Mr. Smith; wasn't that your proposal?

A. That was what I was trying to say, but I guess I said it wrong because Mr. Gardner objected.

Mr. Gardner: I would like to note an objection for [156] the record to that question.

Mr. Hall: I appreciate that, Mr. Gardner.

Q. (By Mr. Hall): But what was Mr. Smith's attitude to such a proposal?           A. He refused it.

Q. He refused what, Mr. Farman?

A. He refused the offer for the corporation to pay him the moneys to relinquish his position as supervisor of the trust and president of the company.

Q. Now, referring to the agreement that is in front of you——

The Court: Did that refusal embrace also or was

(Testimony of Gerald I. Farman.)

there included in the proposal that was refused an offer to buy him out?

The Witness: Yes, and he refused for the corporation, to allow the corporation to buy him out.

The Court: There are two kinds of offers with respect to which there have been testimony. There was a \$25,000 offer which I understand that——

The Witness: Which was rejected.

The Court: Which I understood did not involve this relinquishment of his beneficial interest in the enterprise—involved merely his relinquishing his holding on management, and then I understood that there was a \$50,000 offer which [157] embraces both his relinquishment of his beneficial interest in the entire enterprise as well as his control over management.

The Witness: That's right.

Q. (By Mr. Hall): What, in fact, Mr. Farman, was Mr. Smith's demanding at the time this agreement was signed? I mean, what was his intent?

Mr. Gardner: I object to this witness testifying as to what the intent of Mr. Smith was.

Mr. Hall: Strike that.

Q. (By Mr. Hall): What did he state at that time?

A. He stated he wanted \$25,000 cash—\$25,000 in cash and \$20,000 at the termination of the trust.

Q. Now, referring to that agreement, the agreement spelled out a purchase price, \$45,000 for the whole interest in the company, Mr. Smith's whole

(Testimony of Gerald I. Farman.)

interest in the company, so to speak, \$25,000 payable immediately and \$20,000 after the termination of the trust.

You have mentioned that he was willing to take \$25,000 to get out and then was willing to give up his stock interest for \$20,000. Were the terms changed after that offer and this agreement?

A. The terms were changed to \$50,000 and later to [158] \$45,000, which is a part of this agreement.

Q. Mr. Smith refused to enter into the agreement if it were with the corporation?

A. With the corporation he refused that.

Q. On the date that agreement was signed, did Mr. Smith state that he was happy or unhappy with that agreement?

A. I don't recall him making any statement about the agreement itself.

Q. Did he make any statement in connection with the agreement? A. Not that I recall.

Q. Did he make any statement about being fearful of getting his \$20,000—

A. Yes, he did, very definitely.

Q. Who did he make that statement to?

A. To Mr. Guthrie.

Mr. Gardner: If the Court please, I object to the leading quality of these questions.

Now, he has testified he didn't remember, and then the words were put in his mouth.

This is an important witness, and I think he should remember himself and do his own testifying.

(Testimony of Gerald I. Farman.)

I don't like to object, but there have been numerous instances this afternoon of that. [159]

Q. (By Mr. Hall): Referring to the settlement agreement, Mr. Farman, that agreement calls for \$25,000 to be paid to Mr. Smith at the outset, and the agreement recites that Mr. Smith acknowledge receipt of it on that date. Did you and Mrs. Farman pay any part of the \$25,000?

A. Yes.

Q. What amount? A. \$15,000.

Q. Did that \$15,000 come from personal funds?

A. It did not. We borrowed the money. We didn't have the money.

Q. Who did you borrow it from?

A. We borrowed \$5,000 from Mr. Guthrie, \$5,000 from my mother, and \$5,000 from Miss Garrett.

Q. Pardon?

A. We borrowed \$5,000 from my mother, and \$5,000 from Miss Garrett, Theodora Garrett.

Q. Did you give those persons any written evidence of the loans?

A. We gave them a note involving interest.

Q. Promissory note? A. Promissory note.

Q. Were those notes ever repaid?

A. They were.

Q. When were they repaid? [160]

A. As soon as the trust agreement was completed or terminated.

Q. Were any specific funds used to make the repayment?

A. They were repaid by corporation funds.

(Testimony of Gerald I. Farman.)

Q. By corporation funds do you mean moneys that were paid to you by the corporation?

A. Yes.

\* \* \*

The Clerk: Petitioner's Exhibit 19 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 19 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioner's Exhibit 19 for identification.

Do you recognize that document? A. I do.

Q. What is it, Mr. Farman?

A. It is a promissory note.

Q. It is a copy of a promissory note?

A. A copy of a promissory note in favor of Laura M. Farman, in the amount of \$5,000, signed by myself and [161] Mrs. Farman.

Q. What is the date on it?

A. January 15, 1948.

Q. Is that an exact copy of the note which you gave your mother, Mrs. Farman? A. It is.

Q. In evidence of the loan she made to you?

A. It is.

Q. That note was repaid, is that correct?

A. That is correct.

Q. Do you have the original note? Was the original note returned to you?

A. The original note was returned, yes.

Q. Where is it? Do you have the original note?

A. I do not have the original note.

(Testimony of Gerald I. Farman.)

Q. Do you know what happened to it?

A. I do not know what happened to it. We moved out of the house we were in, and we lost a lot of files.

Mr. Gardner: We do not object to the copy of this document, if that is the purpose, your Honor.

Mr. Hall: For Counsel's information, the—and the Court's, of course, this copy is from our office files and has a pencilled note on it at the bottom by one of the attorneys who was then in the office, and it may be disregarded if Counsel so desires. [162]

Offer this as Petitioner's Exhibit 19.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for Identification as Petitioner's Exhibit No. 19 was received in evidence.)

The Clerk: Petitioner's Exhibit 20 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 20 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioner's Exhibit No. 20 for identification, and do you recognize that document? A. I do.

Q. What is it, Mr. Farman?

A. It is a promissory note in the amount of \$5,000, promissory note dated January 15, 1948, in favor of Theodora Garrett.

Q. Is that a copy of the note that you signed in favor of Theodora Garrett? A. Yes.



(Testimony of Gerald I. Farman.)

Mr. Hall: Offered in evidence as Petitioner's Exhibit 20.

Mr. Gardner: No objection.

The Court: Admitted. [163]

(The document heretofore marked for identification as Petitioner's Exhibit No. 20 was received in evidence.)

Mr. Hall: To save time, your Honor, I have a note in favor, copy of a note in favor of Stanley W. Guthrie, in the sum of \$5,000, dated January 15, 1948.

If there is no objection, I will offer that as Petitioner's Exhibit 21.

(The document above referred to was marked Petitioner's Exhibit No. 21 for identification.)

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Exhibit 21.

(The document heretofore marked for identification as Petitioner's Exhibit No. 21 was received in evidence.)

Q. (By Mr. Hall): The proceeds of the loans which those notes were given for, the proceeds of the loans for which those notes were given were used for what purpose, Mr. Farman?

A. To pay off this blood money, this \$25,000—

Mr. Gardner: If the Court please, I object to the witness' term "blood money."

The Witness: This is what we called it. [164]

(Testimony of Gerald I. Farman.)

Q. (By Mr. Hall): It was used for what purpose?  
A. To pay Mr. Smith the \$25,000.

Q. It was part of the \$25,000?

A. Part of the \$25,000.

Q. That you paid to Mr. Smith, is that correct?

A. That's correct.

The Clerk: Exhibit 22 for identification.

(The document above referred to was marked  
Petitioner's Exhibit No. 22 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you  
Petitioner's Exhibit 22 for identification, and ask  
you if that document bears the signature of Mr.  
Horace O. Smith, Jr.? A. It does.

Q. Will you briefly describe what that is?

A. This is a letter addressed to Guthrie, Darling,  
and Shattuck, attention Mr. Olson, who is attorney—

Q. What is the date of the letter?

A. September 12, 1947.

Mr. Hall: I offer this document as Petitioner's  
Exhibit 22.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as  
Petitioner's Exhibit No. 22 was received in evidence.) [165]

Q. (By Mr. Hall): Mr. Farman, Exhibit 22  
states that Mr. Smith was not agreeable to a proposal  
that had been made by Mr. Olson or Guthrie,

(Testimony of Gerald I. Farman.)

Darling and Shattuck, or from your side of the fence, and offered in return to resign for \$25,000, and to cause Mr. Rousch and Mr. Wackerbarth to resign and offers to give the family an option to buy his stock.

Do you recall that offer?           A. I do.

Q. Was that accepted by you?

A. Yes. I believe that that was, that offer was made in September.

Q. Those are not the terms that are set forth in the settlement agreement or let me ask you this question; Mr. Farman, did Mr. Smith at any time accept any proposal made by the family?

A. No. The family, we were, it was the other way around. Mr. Smith was making the proposals. All of these proposals came from him. We didn't make these proposals.

Q. Did the family accept any of the proposals of Mr. Smith from time to time?

A. My answer is yes.

Q. But what happened to that acceptance or those proposals?

A. He refused to go through with them. [166]

Q. The \$15,000 portion of the \$25,000 that was paid to Mr. Smith by you and Mrs. Farman, the \$15,000, did you expect to be repaid that \$15,000 at the time you made it?

A. Definitely we expected to be repaid.

Q. In what manner did you expect to be repaid?

A. We expected this to be repaid by the corporation.

(Testimony of Gerald I. Farman.)

Q. In what manner by the corporation?

Did you have any specific expectation at that time?

A. It was always the intent that the company would, the corporation would pay back this money that was borrowed to get Mr. Smith's resignation.

Mr. Gardner: If the Court please, the intent of the corporation cannot be established by this witness because this witness was not in control of that corporation at that time.

The Court: He can't testify to the intent of the corporation. The words he used were the intent, and it left me in the dark as to whose intent he was talking about.

Was it your intent?

The Witness: It was the intent of Mrs. Farman, her two daughters, myself, to pay this money, to get this money back.

The family did not have the money. They had to go out and borrow it. That was known to Mr. [167] Smith.

The Court: It was your intention in some form or other to get it out of the corporation ultimately?

The Witness: We first offered, your Honor, and tried to get Bob to negotiate this settlement with the corporation, and he refused.

Then the only alternate we could take was to go out and borrow the money because we were in fact very much concerned over the company's existence and we went out and borrowed the money to include this eruption in the company and to be able to take

(Testimony of Gerald I. Farman.)

it over, and we did not have the money and we had only one source to get it back, and that was through the corporation, and we tried to negotiate with Mr. Smith prior to that for the corporation.

We offered to go out and borrow the money and give the corporation so the corporation could pay him off, and he refused that.

Q. (By Mr. Hall): As a representative of Miss Farman and Mrs. Baker and Mrs. Marlow and as one of the parties paying part of the money, actually paying part of the money to Mr. Smith, I would like you to state, Mr. Farman, what was your intent or yours individually and for the rest of the family in entering into this agreement with Mr. Smith; what was your intent?

A. Our intent, I don't know that—— [168]

Q. What was your purpose?

A. The purpose was to get the corporation out of his control, his absolute control.

Q. In connection with his control, what did Mr. Smith demand in making the settlement, insofar as the stock interest?

A. He demanded that Mr. Guthrie and I personally guarantee—he said that his contention this agreement he didn't like it, that the corporation would go broke before they ever paid off his \$20,000, and he demanded Guthrie and I guarantee the \$20,000, which we did personally guarantee it.

Q. As president of Schalk Chemical Company, thereafter, Mr. Farman, did you at any time consider any action in 1948 or '49 looking towards what

(Testimony of Gerald I. Farman.)

was ultimately done in 1950 to execute an assignment contract; did you consider that, or if you don't understand my question—

A. I don't understand the question.

Q. I will change it.

As a matter of fact, the assignment agreement was not until 1950, and would you explain why, as president of Schalk, you took no action with regard to such an agreement until 1950.

A. I believe I understand it. Well, to begin with, we were advised by counsel, by Mr. Guthrie and Mr. Darling, [169] that this being a spendthrift trust, until the trust agreement was terminated we could not take a chance of paying the money out of it back to the people that we borrowed it from until Mr. Smith had lived and the agreement was terminated, because if Mr. Smith had not lived, the agreement would be not in effect.

We had no way of getting our money back, in that case, but it being a spendthrift trust, we were advised that we could not possibly, he couldn't turn his stock over until the agreement was terminated.

Q. Mr. Farman, I hand you Petitioner's Exhibit 5, which is the minutes of a special meeting of the board of directors of Schalk Chemical Company on December 15, 1950, and I refer you to the resolution commencing on page 3.

Will you glance at that resolution for a moment?

The Clerk: Petitioner's Exhibit 23 for identification.

(Testimony of Gerald I. Farman.)

(The document above referred to was marked  
Petitioner's Exhibit No. 23 for identification.)

Q. (By Mr. Hall): You have read the resolution, Mr. Farman?      A. I have.

Q. I hand you Petitioner's Exhibit 23 for identification, and ask you if that document bears your signature?      A. It does. [170]

Q. That is your signature as president of Schalk Chemical Company?      A. It is.

Q. Mr. Farman, would you describe what this Petitioner's 23 for identification is?

A. It's assignment agreement.

Q. Between what parties?

A. Between Schalk—between Hazel I. Farman, Evelyn Smith, Patricia Baker and the Schalk Chemical Company.

Q. Mr. Farman, did you execute Petitioner's Exhibit 23 for identification in accordance with the authorization contained in the resolution which you read in the minutes of the board of directors of Schalk on the meeting held on December 15, 1950?

A. I did.

Mr. Hall: Your Honor, I offer this as Petitioner's Exhibit 23.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 23 was received in evidence.)

(Testimony of Gerald I. Farman.)

Mr. Hall: Your Honor, I have four checks, and I will number them separately.

The first one, check No. 5234, Schalk Chemical Company, payable to the order of Union Bank and Trust Company, [171] Los Angeles, in the sum of \$20,000, offer that as Petitioner's Exhibit 24.

(The document above referred to was marked Petitioner's Exhibit No. 24 for identification.)

Mr. Gardner: No objection to any of these.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 24 was received in evidence.)

Mr. Hall: Offer check No. 5213 of Schalk Chemical Company, dated February 10, 1958, correction, 1955, payable to the order of Evelyn Smith Marlow in the sum of \$5,788.13, offer that as Plaintiff's Exhibit 25.

(The document above referred to was marked Petitioner's Exhibit No. 25 for identification.)

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 25 was received in evidence.)

Mr. Hall: I offer as Plaintiff's Exhibit 26, check No. 5248 of Schalk Chemical Company, payable to



(Testimony of Gerald I. Farman.)

the order of Patricia Farman Baker in the sum of \$5,788.13, dated February 28, 1951. [172]

(The document above referred to was marked Petitioner's Exhibit No. 26 for identification.)

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 26 was received in evidence.)

Mr. Hall: Finally, I offer as Plaintiff's Exhibit 27, check No. 5204, of Schalk Chemical Company, dated February 10, 1951, payable to the order of Hazel I. Farman in the sum of \$17,364.38.

(The document above referred to was marked Petitioner's Exhibit No. 27 for identification.)

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 27 was received in evidence.)

Q. (By Mr. Hall): Mr. Farman, does Mrs. Farman have any source of income other than from Schalk Chemical Company?

A. No. It's very slight insurance policy, but not considered anything, it's so small.

Q. Now, referring back to your testimony about the time you took annual leave from the position you held at, as [173] chief of supply for the Corps of

(Testimony of Gerald I. Farman.)

Engineers, did in that capacity, were you subject to Civil Service?

A. I was a Civil Service employee, yes, sir.

Q. Did you resign at any time?

A. I resigned in 1946.

Q. Could you have stayed with the Government at that time?

A. Definitely, because it was a professional classification, that of principal engineer and head engineer.

Mr. Gardner: I didn't get the last part.

The Witness: My classification of Civil Service classification was a professional classification, that of head engineer, and principal engineer.

Q. (By Mr. Hall): Mr. Farman, during the years 1935 to 1939, what was your occupation?

A. I was with the U. S. Army Engineers, chief of operations of the WPA—chief of operations of the WPA operations in Southern California.

Q. That was the Southern California Division of the WPA?

A. It was administrated by the Corps of Engineers, U. S. Army.

Q. Approximately how many personnel did you have under your control at that time? [174]

A. Administratively I had between seven and eight hundred administrative personnel, and we were working between 70, and I think our peak was a little over \$100,000.

Q. What was your responsibility as chief of operations?

(Testimony of Gerald I. Farman.)

A. The engineering projects were under my supervision, the selection of projects were under my control. However, there were certain projects, certain political subdivisions recommended that went through higher sources and came to me, but generally speaking the minor projects or the ones that didn't have political force back of them were mine.

The actual running of the projects was a part of operations and the efficient running of the projects were a part of operations. The payroll and other parts were also a part of operations.

Mr. Hall: Thank you, Mr. Farman.

You may examine.

#### Cross-Examination

By Mr. Gardner:

Q. Mr. Farman——

Might I ask the Court how long we will continue tonight?

The Court: I will sit until 4:00 o'clock. [175]

Q. (By Mr. Gardner): Mr. Farman, now that we are on the business of prior occupations, I wonder if we could get a brief rundown of your business history, beginning with your education, sir?

A. I graduated from high school and two years later attended Troop Academy, now Cal Tech, taking a special course, special engineering course sponsored by the Public Utilities of Southern California.

I was selected as one to go to General Electric in Schnectady for further education in 1914, I believe

(Testimony of Gerald I. Farman.)

it was, and I went to Schenectady, I think approximately a year.

Q. You have had three years of education on a college level, is that correct, sir?

A. That was part of it, and I was also selected by General Electric to take the Alexander Hamilton course of business administration, which I completed, and that was approximately a year and a half, I would say.

Q. Do you hold an engineering degree, sir?

A. I do not, no. I don't hold an engineering degree.

Q. You don't have a degree in business administration, either, do you?

A. Oh, no. I maybe received one but I do not have it now.

Q. Where would you have received one [176] from?

A. Business school of Alexander Hamilton School of Business Administration. I graduated, I completed the course.

Q. That had a certificate, did it?

A. Probably got a certificate, but that was many years ago and I do not have it.

Q. What was the duration of that course, one year?

A. About a year. It could have been a year and a half, Mr. Gardner. It's too long ago for me to remember.

Q. Then that was in 1914, approximately, that you went to school, is that correct, sir?

(Testimony of Gerald I. Farman.)

A. Well, summer of '14 and '15.

Q. What positions have you held since that time?

Mr. Hall: Your Honor, I object on the ground that the question is immaterial and incompetent and irrelevant in this proceeding. We have testified as to Mr. Farman's—Mr. Farman has testified as to what he has done since 1935. It would seem that that is sufficient.

The Court: I think it is pretty remote, but we have had comparable remote testimony on direct.

I will permit Counsel to pursue it.

Mr. Gardner: Thank you, your Honor.

Would you read the question back?

(Record read.)

The Witness: I worked for General Electric for one year. [177]

Q. (By Mr. Gardner): What year was that, sir?

A. It was prior to World War I, about '15 or '16.

Q. In what capacity, sir?

A. I guess you'd say sales. I travelled for the United States with Mr. Steinbeck when he introduced the mazda lamp, and I was the business administrator for this tour and took charge of the sales after the introduction of the lamp.

Q. What was your salary, sir?

A. I couldn't tell you. I haven't the faintest idea.

Q. All right, let's go to the next year.

A. After World War I, I was a civilian in World

(Testimony of Gerald I. Farman.)

War I, we had to say that because there are no records of my entry into the Army. After that I was, in fact let me go back prior to World War I, I bought a business on \$300 for borrowed cash. After World War I I conducted my own business. In fact, I had three businesses.

Q. What were those businesses?

A. I was the first distributor for Frigidaire in Southern California. I had all of the counties except Los Angeles County, and I had the east half of Los Angeles County as a distributor for Frigidaire.

I owned the Sierra Madre Electric [178] Company.

I was sole owner of all these companies, sole owner of G. I. Farman Construction Company.

Q. All right, sir, how long did you keep your distributorship of Frigidaire?

A. Until about 1949 when they themselves took over the distribution of Frigidaire throughout the United States.

Q. Until 1949?

A. 1929, I believe. Did I say, '49? I'm sorry.

Q. The Sierra Madre Electric Company, how long did you run that, sir?

A. Until 1930. I sold to Rogers Brothers.

Q. Could you give us an approximation of what that business was worth at that time?

A. At the time of the sale?

Q. Yes, sir.

A. Sierra Madre Electric Company—

(Testimony of Gerald I. Farman.)

Mr. Hall: Your Honor, I do not see the relevancy of this.

The Witness: I don't recall what it is. I would have to remember the indebtedness, the assets and liabilities. I couldn't remember it.

Q. (By Mr. Gardner): What about the G. I. Farman Construction Company?

A. G. I. Farman Construction Company was closed because of the depression. [179]

Q. 1929? A. 1930.

Q. Then in 1930 what did you do, sir?

A. I was unemployed.

Q. How long, sir? A. Oh, about a year.

I took, had various odd jobs, but no steady employment.

Q. When did you finally obtain steady employment?

A. In 1932 Col. Edward Glavis, whom I had known and served under World War I, came out to Los Angeles and called me up and said he was in charge of setting up a division of investigations of the Federal moneys being spent throughout the United States, and asked me to head up this investigation of this body that he wanted to set up here, and I took the job.

Q. By meaning head up, that sounds very impressive. Just what did your duties entail?

A. I was a special agent engineer.

Q. You had no engineering degree, however, you stated, did you?

A. No, but I followed engineering all these years.

(Testimony of Gerald I. Farman.)

Q. You were special agent engineer. Just what did you head up, sir?

A. The division, not bureau, the division of [180] investigations of Southern California.

Now, this money, I believe, in fact I know, was appropriated under the PWA Act. The first moneys, as I recall it, were CWA moneys, and then PWA and then there was also another branch WPA.

Q. How many men did you have under you?

A. There were five men in the group. I was considered the group leader.

Q. You were considered the group leader; did you get more pay than the other men?

A. I believe I did. I got \$3,600 a year and they got \$3,200 a year.

Q. That was in 1932?

A. Yes, 1932, the best of my recollection. It might have been the latter part of '31.

Q. Now, then, how long did you keep this job?

A. I'm afraid I can't tell you. I was probably here in Southern California, was transferred to Washington, D. C., under Col. Fleming, who was chief engineer of the PWA division, as his personal investigator.

Now that could have happened in probably '33, sometime during the year '33.

Q. What was your salary at that time?

A. I know I got an increase in salary, Mr. Gardner. I wouldn't want to say. I don't remember, actually. [181]



(Testimony of Gerald I. Farman.)

Q. 1934, did you continue working as a special investigator?

A. I continued under Col. Fleming until the early part of 1935.

Q. In 1935 what did you do, sir?

A. I would like to cut through this; in the Army and Navy magazine I saw that Col. Donald Connelly had been transferred to Los Angeles. Col. Donald Connelly was an Army engineer and I had served under Col. Connelly at one time when he was a Major, and asked Col. Fleming to transfer me back home, this being my home, and I was transferred, and that was my entry into the position that Mr. Hall brought up in 1935.

Q. Do I understand correctly, sir, that from 1933 to 1935 you were in Washington, D.C.; that was your post of duty?

A. That was my headquarters. However, I covered about 18,000 miles a month, believe it or not.

Q. In other words, your headquarters, your base, was in Washington, D.C.?

A. That's right. That's right.

Q. Where did you consider your home at that time, sir?

A. My home is Southern California.

Q. Still in Southern California? [182]

A. That's correct.

Q. Now we are in 1935 and you are taking over this other job. How long did you keep that job?

A. Until the Army engineers, the staff of Army

(Testimony of Gerald I. Farman.)

engineers assigned to Southern California were transferred out a year, and that was the latter part of 1939.

Q. During this period I believe you have testified that you were chief of the WPA for Southern California?

A. Chief of operations, sir.

Q. Chief of operations? A. I was not—

Q. What was your salary—excuse me?

A. I said that was not a political job. I was under the Army engineers.

Q. I don't mean to make any implications.

A. That's all right, I'm sorry.

Q. What was your salary, sir?

A. Well, it would be a mere guess. I would say \$750 a month.

Q. \$750 a month?

A. Yes. Biggest job in Southern California. The biggest job I ever had and the biggest job I ever expect to have, sir.

I can't say definitely for the record that I went in at that. I can definitely say I went in at \$550 a month. [183]

Q. You went in at \$550 a month?

A. I can say for the record that I was supposed to be the highest paid civilian on the Pacific Coast. [184]

\* \* \*

Q. (By Mr. Gardner): Mr. Farman, as we concluded yesterday, we were discussing your job with

(Testimony of Gerald I. Farman.)

the WPA, or some branch of that agent, in 1935 to 1939; is that correct, sir?

A. That is correct.

Q. I believe that the salary you stated that you drew from this position was \$550 a month to begin with, may have gone as high as \$750 a month?

A. I don't recall how high it went, Mr. Gardner. I was transferred from one agency to another, and I recall that my salary was \$550 when I was——

Q. \$550 a month?

A. That is what I recall.

Q. Did you have a civil service rating?

A. I have.

Q. What was your rating in civil service?

Mr. Hall: At that time?

Q. (By Mr. Gardner): At that time.

A. I didn't have a rating at that time. That was why I hesitated. I did not have a rating at that time. [187]

Q. You did not have a rating?

A. Not at that time.

Q. Now, just what exactly was the title of this position that paid \$550 a month?

A. Director of operation, Southern California.

Q. This was a WPA project?

A. This was WPA, operated as a separate district by the Army Engineers at the request of the President of the United States.

Q. All right. Now, you were known as director of what, sir?

A. Operations.

(Testimony of Gerald I. Farman.)

Q. Who did you report to?

A. To Col. Donald H. Conley.

Q. Do you know how much Col. Conley was making then?

Mr. Hall: I object your Honor, on the ground——

The Witness: I wouldn't know.

Mr. Hall: ——immaterial and remote to the issues of this case.

Mr. Gardner: If the Court please, this is a rather difficult thing to do, to run down the salaries that were being made at that time.

Now, it is the Respondent's position that this testimony is, at least as to salaries, is rather inflated to show a background here, \$550 a month in the year 1935. [188] We have made every effort to track this down, and we are still making an effort. It is extremely high; it is more than the Colonel was making.

The Congressmen at that time were making only \$10,000 a year. The Governor of this state was making only \$10,000. And this is a WPA project.

We seriously doubt the truth of that statement, and we are doing what we can to run it down and attempt to discredit it.

Mr. Hall: Well, to discredit it, your Honor, if that is the attempt, I don't see that Mr. Gardner is attempting to say that Mr. Farman did not hold these positions. What a person was paid as a salary 20 years ago, or more, certainly is something that is easily forgotten.

(Testimony of Gerald I. Farman.)

In fact, I don't see that the question of salary has any bearing on this case at all.

The Court: Well, the pending question has to do with the salary of the Colonel, to whom this witness reported.

Mr. Hall: Yes.

The Court: I think that is getting pretty remote.

Mr. Gardner: Yes, sir.

Q. (By Mr. Gardner): Now, Mr. Farman, let's go back to the year 1931. I believe you testified that Bob Smith, that is, Horace O. Smith, Jr., lived with you; is that correct, sir? [189]

A. When we was first married; yes, sir.

Q. When you were first married.

Mr. Hall: When who was first married?

The Witness: When Mrs. Farman and I were first married, August 19—

Q. (By Mr. Gardner): That is Bob's mother?

A. Yes.

Q. Formerly Mrs. Horace O. Smith; is that correct, sir? A. That is right.

Q. Now, where did you live after you were married, sir?

A. In Mrs. Smith's mother's home in Sierra Madre.

Q. Is that where Bob lived with you, sir?

A. Yes.

Q. Had that been Bob's home all his life?

A. Yes. Not all his life.

Q. Practically all his life? A. Practically.

Q. That is where he grew up?

(Testimony of Gerald I. Farman.)

A. That is right, from 1921.

Q. How old was he, about 17, at that time?

A. I said that was my recollection.

Q. So he was just living where he had always lived; [190] isn't that right?

A. That is right.

Q. Now, did you ever, during the period that you were unemployed, that is sometime in 1931, did you ever make any attempt to get a job with Schalk Chemical?

A. I don't recall it, sir.

Q. All right. During the period 1931 to 1935, did you attempt to get a job with Schalk Chemical?

A. Not to my recollection.

Q. You would remember, if you did, wouldn't you, sir?

A. Not necessarily; that is a long time ago.

Q. During the period 1935 to 1940, did you attempt to gain employment with the Schalk Chemical Company?

A. Not to my recollection.

Q. It is possible that you did, though, isn't it?

A. What is?

Q. It is possible that you did attempt to get a job at Schalk Chemical, isn't it?

A. That last term, '35 to '40, it is not possible.

Q. It is not possible?

A. I had a very good job and I was very interested in my work.

Q. I see. Now, from 1940 to 1945, did you at-

(Testimony of Gerald I. Farman.)

tempt to get a job with Schalk Chemical [191] Company? A. Not to my recollection.

Q. Not to your recollection. It is possible that you did attempt to get a job there?

A. I would seriously doubt it, because I was stationed in San Francisco during that period.

Q. Did you write letters to Schalk Chemical?

A. No doubt I did. I have no recollection.

Q. Did you ever seek employment?

A. Not to my knowledge.

Q. Not to your knowledge. Now, is it your testimony, sir, that to your knowledge you never sought employment with Schalk Chemical Company from 1931 through 1945?

A. I never sought employment with Schalk Chemical on my own during any period.

Q. Well now, would you explain that statement, sir? I would like to have that explained.

A. I married Mrs. Farman in 1931; I believe I am a dutiful loyal husband, and it was my duty to do everything in my power to preserve Mrs. Farman's financial status, her ability to retain what was rightfully hers.

If she asked me to go into Schalk, I think that was a matter of her personal request. It was not a request from me.

Q. What would you do when you went into Schalk?

A. I was asked to go in by Mrs. Farman and her two [192] daughters.

(Testimony of Gerald I. Farman.)

Q. Now, these two daughters, in 1931, how old were the two daughters?

Mr. Hall: What year?

Mr. Gardner: 1931.

The Witness: I don't know. Pat was quite young; Evelyn, as you know her in the books, is one year older than Bob. She was probably 18. Pat was quite young, probably 8, 7, or 8. That is as close as I can give you [193]

\* \* \*

Mr. Gardner: All right.

Q. (By Mr. Gardner): Let's go on then, Mr. Farman. During the period 1931 to 1935, do you recall contacting Schalk Company in any way?

A. Contacting them? [194]

Q. Yes.

A. Well, I don't recall any specific instance of contacting them, but as the husband of the principal owner of Schalk, I naturally was in constant touch with the company's progress and so forth.

Q. You were? . A. Yes.

Q. That is 1931 to 1935. Now, you were looking after Mrs. Farman's interests? A. I was.

Q. And during that period, does that now help you to refresh your recollection as to whether or not you sought employment with Schalk?

A. I didn't personally seek employment with Schalk. Mr. Colyear was the president and supervisor of the trust, and I never asked Mr. Colyear, to my knowledge, for a job. My wife might have;



(Testimony of Gerald I. Farman.)

she did; Bob Smith, she asked Mr. Colyear to employ him.

Q. Well, would you wife make such a request with your knowledge?

A. With my knowledge?

Q. Yes.

A. She would, or without my knowledge. I don't recall any instant.

Q. Would you like to have gone to work for Schalk [195] during that period, sir?

A. Not under the trust, no, I wouldn't.

Q. You didn't want to go to work for Schalk under the trust? A. No.

Q. What changed your mind in 1956?

A. I was asked to go to work for Schalk in August, 1946.

Q. Who asked you?

A. Mrs. Farman and the two daughters.

Q. Did she ask you in 1935?

A. Not to my knowledge.

Q. That changed your mind completely in 1946, mere fact that they asked you?

A. I call it being drafted.

Q. You call it being drafted? A. Yes.

Q. I see. Now, let's go back to that job you had with the army. What was that now, during 1942, 1943, what was that job, sir?

A. It was from August, 1940 through 1945, sir.

Q. Through 1945? A. Chief of supply.

Q. Chief of supply. I believe you testified that that was a permanent job, did you not, sir? [196]

(Testimony of Gerald I. Farman.)

A. I testified it was a civil service job.

Q. Civil service job. And did that job cease to exist in 1946? A. Not to my knowledge.

Q. It did not. Who holds that job today, sir?

A. I don't know.

Q. You know that job doesn't even exist, don't you?

A. No, I don't know that it doesn't exist. I haven't been in touch with the Army Engineers since 1945 when I left there.

Q. Well now, you testified that you could have still kept working, didn't you, sir?

A. I did. I assumed I could under civil service.

Q. They don't ever lay off civil service employees? A. They do.

Q. They do?

A. But not usually a good employee.

Q. Not usually a good employee?

A. That is right.

Q. Supposing the job just ceases to exist?

A. Often they transfer them.

Q. They transfer. I believe you did state that near the end of the war the position that you held you weren't very busy? A. That is true. [197]

Q. Because the reason for that position to exist was now going out of business; is that right?

A. It was supply. No, it isn't right it was going out of business, not to my knowledge. It just, the purchasing dwindled down as the war was ending, and there was certainly no indication to me that the job was going to be discontinued in any way.

(Testimony of Gerald I. Farman.)

Q. There was no indication to you?

A. Not at all.

Q. That this job was going to go on through peace time like a big war: is that right, sir?

A. I can absolutely say that to my knowledge they still have a supply department down here at this engineer office, which was, came under my supervision at that time.

Q. How much did you state you were making?

A. I didn't state.

Q. What did you state, sir; would you state, sir?

A. I stated that my classification was principal engineer.

Q. Principal engineer. And how much were you making, sir?

A. I don't know. Principal engineer classification is a matter of available to anybody that wants to go find out?

Q. Did it have a P rating?

A. Yes. [198]

Q. What was the P rating?

A. I don't know, P1, P2, 3 or 4. I don't know.

Q. Could it be as much as \$300 a month?

A. It was more than \$300 a month.

Q. It was more than \$300 a month.

Now, how did you first become employed with Schalk Chemical Company?

A. How did I first become employed in September, 1945?

Q. Yes, sir.

A. I was asked first by Mrs. Farman to see if we

(Testimony of Gerald I. Farman.)

could not arrive at a satisfactory agreement, and cut out, or eliminate the strife, the antagonism, and so forth. And I believe that I suggested to Mr. Smith, and the executive committee, I believe I did—I am not sure—and I do believe that Mr. Smith asked if I would serve on that committee, and if he did, my answer was yes, because I did serve on it.

Q. That was in 1945, wasn't it, sir?

A. That was in 1945.

Q. What was your salary with the——

A. Again, I believe it was \$450. I can look it up.

The Court: Salary with whom? [199]

Q. (By Mr. Gardner): With Schalk Chemical?

A. Schalk. I believe it was \$450.

Q. \$450. How much was the president making, Mr. Farman? A. I do not know.

Q. Could it be the president was making about \$300? A. I don't know.

Q. You don't know very much about salaries, do you, for an executive?

A. No. I don't remember back 20 years. In fact, I have——

Q. This is the period——

A. I have the future to look to, and not the past.

Mr. Gardner: I see.

I would like to have this marked as Respondent's next in order, please.

The Clerk: Respondent's Exhibit I for identification.

(The document above referred to was marked Respondent's Exhibit I for identification.)

(Testimony of Gerald I. Farman.)

Q. (By Mr. Gardner): Mr. Farman, I hand you what has been marked Respondent's Exhibit I for identification. The heading at the top of that document is chronological classification account pay schedules. [200]

Now, would you examine that document, sir, and see whether or not you can now tell me what you were making in 1942, '3 and '4?

Mr. Hall: Your Honor, I object to the question, on the ground that the document which Mr. Gardner has put before the witness is dated July, 1951.

Mr. Gardner: If the Court please, may I clarify that?

It shows as each account comes in, your Honor, 1928, 1930, '42, on the far side of the document. It shows the classification and pay of those dates.

Mr. Hall: Your Honor, this is apparently a Government schedule which Mr. Gardner is asking Mr. Farman to interpret. It is dated as of July, '51. It has a lot of footnotes to it, to be sure to refer to accounts earlier. I think it is an unfair question, in the first place, in that the question based upon it, and based upon a schedule which is dated July, 1951, is an improper question to this witness.

The Court: May I see the schedule?

The Witness: Yes. Excuse me, sir.

The Court: It is possible that the schedule may stimulate the witness' recollection, and if it does, the witness may answer.

The Witness: I already stated, your Honor, that I do not know what classification, in the professional

(Testimony of Gerald I. Farman.)

class that [201] principal engineer is; I recall the word principal engineer.

Q. (By Mr. Gardner): I see, sir.

A. And I would have to know what class it is, plus the fact that there were extras during the war, over and above your base pay.

Q. There were extras over and above?

A. I received extras, myself, over and above base pay.

Q. I see, sir; but this does not help you in any way?

A. I don't know what classification. I stated that before, Mr. Gardner.

Q. I see.

A. I don't know whether it is P4, P5, P1, P2. I don't know. If I knew, I would state quickly.

Mr. Gardner: If the Court please, at this time I would like to offer this document in evidence to show——

Mr. Hall: I object.

Mr. Gardner: ——to show, if the Court please, the prevailing salaries during these periods testified to by this witness.

Now, I do that for this reason, too, your Honor, the Petitioners are making an attempt here to set up this witness as a fine executive, and a man accustomed to very important positions, so that when he comes into the Schalk [202] picture, here is an expert now finding fault, if you might, with the management of Schalk.

As a natural matter of fact, there is nothing in his

(Testimony of Gerald I. Farman.)

background to show that he is a businessman at all, an engineer, maybe, yes, but not a businessman. And these fantastic salaries that he has testified to, \$550 to \$750 in 1935 WPA, is just almost beyond reason.

Mr. Hall: I object to the offer in evidence of that document, your Honor, on the ground that it is immaterial to the issues in this case. It is a remote issue. The witness testified as to his best recollection.

The question of how much he was paid has nothing to do with the point that Mr. Gardner is attempting to pursue. He has not asked him what his duties were, or his qualifications were in that, in those various jobs, and what he was paid is completely beside the point.

The Court: The exhibit is not very helpful, because it is geared to classifications and this witness' classification has not been established. However, I will let it in for whatever it may be worth. As it stands now, it will be of very little aid to the Court.

The Clerk: Exhibit I.

(The document previously marked for identification as Respondent's Exhibit I was received in evidence.) [203]

Q. (By Mr. Gardner): Now, we are up to a time when you first gained employment with Schalk Chemical Company. That is in September of 1945; is that correct, sir?           A. Yes, sir.

Q. What was your job at that time?

(Testimony of Gerald I. Farman.)

A. Expediter.

Q. Expediter.

The Court: I might inquire of counsel, in connection with Exhibit I, whether or not the data appearing hereon couldn't be found in the statutes of the United States in any event?

Mr. Gardner: Yes, they can, your Honor.

The Court: So that it is a matter of public knowledge.

Mr. Gardner: It is a matter of public knowledge, but I would just like to have it here for the purpose of bringing it in one document, your Honor. That is, it is my understanding that is public knowledge.

Q. (By Mr. Gardner): All right, sir, we are back to 1945, again, September. You stated you were an expediter? A. That is right.

Q. Now, just what was your job as expediter, sir?

A. To obtain materials for the production in Chicago, mainly.

Q. In Chicago? [204]

A. Mainly, not all. I said mainly Chicago, not always Chicago.

Q. Mainly. Now, you testified, I believe, sir, that you did go to Chicago; is that correct, sir?

A. That is correct.

Q. You testified you went there with Mr. Smith?

A. That is correct.

Q. Now, how long did Mr. Smith stay in Chicago on that trip?



(Testimony of Gerald I. Farman.)

A. Well, I wouldn't recall; probably, I would guess two weeks.

Q. Two weeks?

A. I don't know; I am just guessing.

Q. How long did you stay?

A. Frankly, I don't recall.

Q. This was——

A. That is a very hard thing to remember, details like that.

Q. Well, you couldn't get all of these new sources of supply just overnight, could you?

A. I went to New York from Chicago, Mr. Gardner. I testified to that.

Q. Surely. And you did obtain new sources of supply, didn't you, sir?

A. I did, yes. [205]

Q. That was just your job, wasn't it?

A. That was just my job.

Q. You wouldn't do anything else that anybody else wouldn't do?

A. I had done something that no one else had done.

Q. Had there been an expediter before?

A. They had managers, three of them.

Q. Had they had expediters?

A. I don't think so.

Q. That is why they hired you?

A. They hired me, yes.

Q. Sure. So all you were doing was doing your job, isn't that right?

A. I was doing what my wife—for my wife, yes.

(Testimony of Gerald I. Farman.)

Q. And who was getting the pay?

A. My wife.

Q. Your wife would pick up your pay check, sir?

A. Yes, sir.

Q. I see. Does she maintain a separate bank account?

A. She does.

Q. And you can't lay your hands on it, sir?

A. I don't want to.

Q. You didn't answer my question.

A. I can't lay my hands on her bank account.

Q. Right. [206]

A. I don't know the legal status of my—I am not interested in laying my hands on her bank account.

Q. Now, it is your testimony, sir, that your wife picks up your salary check from Schalk, and puts it in her bank account?

A. May I—is this all right, Mr. Hall? I don't know. I would say it is my personal business; nothing to do with this unless the Judge wants me to answer.

Q. Well, I want you to answer.

A. I said that I had not accepted a check from Schalk. That is the answer.

Q. Where did the check go?

A. To Mrs. Farman.

Q. You have never accepted anything from Schalk?

A. From or up to now, is this your question?

Q. Up to now.

A. It is absolutely right. I never have taken a

(Testimony of Gerald I. Farman.)

nickel from the Schalk Chemical Company up to now. I endorse my checks over to Mrs. Farman. It is her company and her business.

Q. Do you have a bank account, Mr. Farman?

A. I do.

Q. Where do you get the funds that go into your bank account?

A. I think that is personal. [207]

Q. Yes, it is. Let's find out, where do you get the funds?

A. It is personal. I refuse to answer.

Mr. Hall: I object on the ground that Mr. Farman's income from private sources is not an issue in this case. If he has such income, that is his personal business. I don't see that it has anything to do with this case. It is immaterial, incompetent and irrelevant.

The Court: Mr. Gardner.

Mr. Gardner: Well, if the Court please, I am rather startled by the testimony of the witness to say the least. Apparently here is a man with wings, an angel no doubt. He works hard; he gets absolutely nothing out of it. Yet, he must have some funds.

Now, where does he get these funds? He didn't have in 1935, he didn't have them when he was broke in 1931.

The Witness: Did you establish——

Mr. Gardner: I don't know——

Mr. Hall: Your Honor——

Mr. Gardner: How he is doing this, or, and I do want to get into it. I would like to find out what

(Testimony of Gerald I. Farman.)

this wonderful source of supply he has of funds.

Mr. Hall: Your Honor, the arrangements personally between Mr. and Mrs. Farman, as to what they do with their [208] income, whatever it may come from, is of no concern to this case. It is immaterial, and has nothing to do with the issues that are involved here.

The Court: Well, one of the central issues in the present case goes to the controversy which is alleged to have persisted with respect to the Schalk Chemical Company, and this witness has—and this witness' testimony that he never took any money from the Schalk Chemical Company, notwithstanding his rendition of services, is rather surprising, and I think Counsel is entitled to pursue the implications of that.

Mr. Hall: Well, your Honor, it has nothing to do with the controversy. The controversy that has been discussed is between the management of Schalk during the period, the management composed of Mr. Smith and the persons whom he had designated, and the rest of the family; those two groups, if you please.

The Court: Well, it goes to the relationship of this Petitioner with Schalk; it goes to the accuracy of his testimony that he has never taken anything from Schalk.

Mr. Hall: Well, your Honor—

The Court: And I rule that the witness may answer.

Mr. Hall: Thank you.

(Testimony of Gerald I. Farman.)

The Witness: I have a personal income, a small income that takes care of my needs. [209]

Q. (By Mr. Gardner): All right, sir. How small is this income?

A. It is less than \$300 a month.

Q. Less than \$300 a month? A. Yes, it is.

Q. And this is only money that you use, \$300 a month; is that right, sir?

A. That is correct, yes.

Q. And——

A. I am not talking about principal, I am talking about my income, interest income.

Q. What is the source of the \$300 a month, sir? A. Private.

Q. All right, private. Private what?

A. I have some money out at interest.

Q. How much money, sir?

A. I don't know why I have to answer these questions.

Mr. Hall: Your Honor, I would like to object again. It is completely beyond the issues of this case; it is immaterial, unrelated. It is argumentative to quite a degree.

The source and how much money Mr. Farman has invested somewhere, and where he has it invested, is immaterial to the issues of this case, your Honor.

I might state that Mr. Farman said he didn't [210] take anything from Schalk Chemical Company. He later said that he endorsed the checks, I mean, it is a matter of language.

(Testimony of Gerald I. Farman.)

The Court: I interpret his testimony to mean that he did not benefit financially. The situation seems rather surprising. I don't know whether the matter will ultimately turn out to be relevant or not. At the present time, it is potentially relevant.

If it should turn out not to be, I shall entertain a motion to strike.

Mr. Gardner: Would you read the last question?

(Question read.)

The Witness: This was out at interest, is this what you are——

Q. (By Mr. Gardner): Yes. I was referring to it, you testified, I believe, that you have approximately \$300 a month income from an investment, interest income.

The Court: Would you fix the date, Mr. Gardner?

Q. (By Mr. Gardner): That is as of what date, sir?

A. I would assume today is what you are talking about.

Q. All right. Today, sir. And in fact, going back to 1945, how much interest income did you have, or what was [211] your source of income?

A. Mr. Gardner, that, my income has varied during this period. It has been high at some times, and practically nill at others.

Q. In 1945, what was your income from this source? What I am trying to find out, Mr. Farman, is what is the source of this income?

(Testimony of Gerald I. Farman.)

Do you have a large amount of cash on hand that you invest, or what?

A. I had investments of various kinds. I have sold my investments, from time to time, stock, for instance.

Q. Stock?

A. Now, if you would like to know the names of the companies, I am afraid that I would have to go back to my records with McKesson-Thompson and Company, who handle my account, and find out; the last was a Canadian stock that I invested in, and I sold it at a profit.

Q. I see.

A. And I have investments of \$5,000, investment in a mortgage for instance, right at the moment. I have not a big income, as you see, and they are all from small investments.

Q. You have small investments that bring you in approximately \$300 a month as of today?

A. No. I said less than \$300 a month. [212]

Q. Less than \$300 as of today?

A. As of today.

Q. And this income is from investments such as \$5,000 mortgage?

A. Stock investments, and small stock investments.

Q. Stock investments. Did you have this nut, or this principal sum that you are now using to invest in mortgages and various stocks that you have, did you have that amount back in 1945?

A. To say that I had the exact amount that I

(Testimony of Gerald I. Farman.)

have today, I would not be able to answer. I had some money back in 1945.

Q. You had some money. Did you have as much in 1945, as you have today?

A. I own stocks in 1945.

Q. Just answer the question.

A. No, I can't answer.

Q. Do you have more today than you had back there then?

A. I don't think I did, no. I think I had more back there than I have today.

Q. You have lost money on your investments then? A. No, I haven't.

Q. What has happened to them; why have they been reduced then? [213]

A. I was receiving my pay in 1945 from the Government, that I kept myself, or helped to support the family with it, in 1945. You mentioned 1945?

Q. Yes.

A. And I had that income, whatever it was, as a principal engineer.

Q. What happened to your investments, if they went down?

A. I didn't say my investments went down. I said I do not recall whether, on a balance sheet, I had as much in 1945 as I have today, or less. Or less, I have no idea. I would have to go figure it out.

Q. Your testimony, as I understand it, is now that the sole income that you have had from 1945



(Testimony of Gerald I. Farman.)

to 1958, results from your investments, and is now approximately \$300 a month; is that correct, sir?

A. It is not exactly correct, and that was not my testimony.

Q. All right. Let's straighten it out. What was your testimony?

A. I said from 19—during 1945, '46 and I will add '47, if you wish, my income was not of a steady nature. I made money at one time, and maybe there was a lull in between. From 1948, January, 1948, to 19—to date, I stated that I have endorsed the checks that I receive as [214] president of the company over to my wife, and that I have my own independent income, which is less than \$300 a month.

Is that clear?

Q. No, it is not exactly clear. I understood that you did that from 1945 on.

A. No. I didn't say from 1945. I said that during 1945 the checks that I received from Schalk were endorsed to my wife.

Q. All right.

A. That is what I stated.

Q. Did she get the proceeds from that check?

A. Yes.

Q. Well, how did that differ from what is going on in 1948; isn't that exactly the same process you are going through now?

A. It didn't differ from 1948, but there has been a lapsed period in there that you have incorporated, which I refuse to have in there, as 1947.

(Testimony of Gerald I. Farman.)

Q. All right. In 1946, did you do the same thing with the checks?

A. I did, to my best recollection, yes.

Q. That is, you received absolutely nothing from Schalk, yourself?

A. I don't say—I said to my best recollection, in 1946, I did. [215]

Q. Well now, did you or didn't you?

A. I don't know. I said, to my best recollection I did.

Q. You did what?

A. I endorsed the checks over to Mrs. Farman.

Q. That includes your salary check?

A. My salary checks is what I am talking about.

Q. I see. Did you ever get any proceeds for being, during one period there I believe you were vice president of the corporation, were you not, sir?

A. In 1946, during—I don't know from February on I think.

Q. You voted yourself a bonus of \$1200 during that year, didn't you, sir?

A. If I did, it is a matter of record. I didn't vote myself that. I couldn't vote myself that.

Q. Didn't you?

A. The directors should vote a bonus to employees, I believe.

Q. Didn't you offer the resolution?

A. I may have, yes. I don't recall it. It is a matter of record.

Q. Now, going back to 1931 again, now, we are going to cover the management of Schalk Company.

(Testimony of Gerald I. Farman.)

From 1931 to 1942, who was the president and supervisor? [216]           A. C. C. Colyear.

Q. C. C. Colyear?           A. Yes.

Q. What sort of an individual was Mr. Colyear, as far as you know, sir?

A. He was a businessman. He had a chain of automotive, I guess you would say automotive part stores on the West Coast.

Q. Was he a good businessman, sir, in your opinion?

A. Why I would say a man that had built up a chain of stores would be considered a good businessman, in my judgment.

Q. Now, he managed Schalk from 1931 to 1942; is that correct, sir?

A. Up to the time of his death, I believe, or just prior to his death, he resigned.

Q. And this includes that period that had you so worried; that is 1939, doesn't it, sir? I believe you testified——

Mr. Hall: Your Honor——

Mr. Gardner: To refresh your recollection, that it was your opinion that the company was on the skids in 1939?

The Witness: That is correct.

Q. (By Mr. Gardner): All right, sir. Now, this is the same man, [217] Mr. Colyear?

A. Yes, sir.

Q. Good businessman?           A. That is right.

Q. That was running the company at that time; is that correct, sir?

(Testimony of Gerald I. Farman.)

A. That is correct. He was running the company at that time.

Q. Yet, according to you, it was next door to bankruptcy?

A. I didn't say it was next door to bankruptcy. I stated the company and stated figures to back me up, the products produced by the company were on the downgrade in 1939. I can't recall my words, but——

Q. That was at a time when the management of that business was in the hands of a good businessman; isn't that correct, sir?

A. I wouldn't say it was correct, sir.

Q. What would you say was correct?

A. I would say that Mr. Colyear, this is hearsay evidence, that Mr. Colyear never, at any time, was in the Chicago plant during the time of his regime as president of the company, and supervisor of the trust.

I would say that he paid very little attention to the Schalk Chemical Company in any way, shape or form. [218] It was a trust and it was, he held it intact.

Q. I see. Are you finished?           A. Yes.

Q. I am sorry I interrupted you, sir.

How many times did you go down and visit Schalk during the period 1931 to 1940, sir?

Mr. Hall: I can't hear you, Mr. Gardner.

Mr. Gardner: Excuse me. I asked how many times he visited the Schalk Company from 1931 to 1940.

(Testimony of Gerald I. Farman.)

The Witness: I would be unable to answer that, Mr. Gardner. I wouldn't even know if I was down there once in that length of time.

Q. (By Mr. Gardner): And you wouldn't even know whether Mr. Colyear was there or not, would you?

A. I did not make my statement as to this plant. I made my statement as hearsay evidence, from the manager in Chicago, that he never, at any time, during his reign as president and supervisor of trust, ever visited the plant in Chicago.

Q. Now, during this period, that is 1931 to 1942, when Mr. Colyear was supervisor, or and president, who was the manager of the Los Angeles plant?

A. I believe Mr. Lieben was.

Q. Mr. Lieben? [219]

A. My understanding, yes.

Q. All right. Then how long had Mr. Lieben been there?

A. I believe he came in as a bookkeeper. In my understanding, he was there in the '20's, when I first met him.

Q. When did you first meet him?

A. I can't tell you the exact date. During the 1920's.

Q. Did you know Horace O. Smith?

A. Very good friend of his, sir.

Q. That is Horace O. Smith, Sr.? A. Sr.

Q. We are talking about? A. Yes.

Q. Horace O. Smith, Sr., apparently employed Mr. Lieben; is that correct, sir?

(Testimony of Gerald I. Farman.)

A. I believe that is correct; I don't know.

Q. And Horace O. Smith, Sr., owned all the stock in Schalk Chemical prior to his death, didn't he, sir?

A. I couldn't answer that. I don't—my recollection, I should be able to remember it, but I don't know. There might have been a small block of outstanding stock. I am not sure.

Q. In any event, under the terms of the will, are [220] you familiar with the will?

A. Yes, sir.

Q. Under the terms of the will he left all the shares of stock to his mother and his three children; didn't he?      A. That is right.

Q. He didn't leave any to Mrs. Smith, did he?

A. That is correct; that is correct.

Q. So, he must have had all the, all of the stock at the date of his death?

A. Must have, yes.

Q. And during that period, Mr. Lieben was the supervisor, or wasn't he, or he managed the plant, too, didn't he, under Mr. Horace O. Smith, Sr.?

A. What period?

Q. Under the period prior to Horace Smith, Sr.'s death?      A. No, he didn't.

Q. What did he do?

A. He was bookkeeper.

Q. He was bookkeeper?      A. Yes.

Q. Who managed the plant, do you know, sir?

A. Jack Williams.

Q. Jack Williams. What happened after Mr.

(Testimony of Gerald I. Farman.)

Smith, Sr. [221] died, as far as Jack Williams was concerned?

A. Mr. Colyear fired Jack Williams, because he was a friend of Mrs. Farman's and was reporting what was going on to Mrs. Farman direct.

Q. So, Mr. Colyear got rid of him?

A. Got rid of him.

Q. He cut out dissension right now, didn't he?

A. No dissension, there was no dissension back at that very time that he was fired.

Q. All right, sir. Now, that means that Mr. Lieben was then put in as supervisor or manager; is that right, sir?

A. Those are your words; I don't know.

Mr. Hall: Your Honor, I object to Mr. Gardner using the word supervisor, or manager, in the manner in which he is doing it, because it is confusing to the witness. Now, we have——

Mr. Gardner: That is well taken.

Mr. Hall: We have a supervisor under the trust. Let's keep the terminology straight.

Mr. Gardner: Very good.

Q. (By Mr. Gardner): It was after Mr. Williams' departure that Mr. Lieben became the manager of the plant in Los Angeles plant? [222]

A. This Los Angeles plant I believe is correct, yes.

Q. Is that right, manager of the plant?

And that would be in approximately 1931; is that correct?

A. No, I don't think it is correct. I don't think

(Testimony of Gerald I. Farman.)

Williams was fired in '31. I think he was fired after that.

Q. '32?

A. I imagine '32 or '33, I have no——

Q. In any event, Mr. Lieben was placed in his position which we will call manager of the Los Angeles plant, by Mr. Colyear who had a fine reputation, I suppose, as a businessman; is that correct, sir?

Mr. Hall: I object to the question on the grounds it is argumentative, limited to the first part of the question.

The Court: Sustained.

Mr. Gardner: All right.

Q. (By Mr. Gardner): He was placed in that position by Mr. Colyear?

Mr. Hall: If you know, Mr. Farman.

The Witness: I don't know that he was.

Q. (By Mr. Gardner): In any event, Mr. Colyear was supervisor at that time? [223]

A. He was supervisor.

Mr. Hall: What year?

Mr. Gardner: Talking about the year Mr. Williams departed. We don't know what year.

Mr. Hall: How can the witness answer the question?

Mr. Gardner: Because he is the one that doesn't know the year. He knows that Mr. Williams left and at the same time Mr. Lieben was placed in as manager.

Mr. Hall: He said he doesn't know.



(Testimony of Gerald I. Farman.)

Mr. Gardner: He said what?

Mr. Hall: He doesn't—said he didn't know.

The Witness: That is correct, I don't know.

Q. (By Mr. Gardner): You don't know that, whether or not Mr. Lieben was placed in the position of manager?

A. After Mr. Williams was fired, I certainly do not know.

Q. Weren't you keeping close touch with Schalk?

Mr. Hall: What year, Mr. Gardner?

Mr. Gardner: When Mr. Williams left. When Mr. Williams left.

Mr. Hall: Well, the witness said he didn't know when Mr. Williams left.

The Court: The question is a proper one. Proceed.

The Witness: I do not know if Mr. Lieben was given [224] the job that Mr. Williams had when Mr. Williams was fired. I do not know. I do know—well, go ahead, go ahead. I am sorry.

Q. (By Mr. Gardner): Do you know whether or not Mr. Lieben was ever—

A. Yes, I do.

Q. Ever what? A. Manager.

Q. Manager of what?

A. Of the Los Angeles plant.

Q. When did you first make that discovery?

A. Well, it was during the period of—well, it was in the 1930's, when Mr. Lieben sent some reports into the directors. I was not a director. I was with Mrs. Farman, who was in very poor health,

(Testimony of Gerald I. Farman.)

and Mrs. Farman's attorney at a director's meeting, and there was a report from Mr. Lieben to Mr. Colyear, and I believe that all it was signed was Lieben. The inference was that he was managing or taking, was manager of the Los Angeles plant.

Q. What year was that, sir?

A. I can't tell you the exact year.

Q. That is the first you knew about it?

A. Well, it occurred several times during the period that Mr. Colyear was president and supervisor of the trust. I would say during the period of 1935, to 1940. [225] I attended several directors' meetings with Mrs. Farman, because of her health.

The Court: When did you first learn of, Mr. Lieben was the manager of the Los Angeles operation?

The Witness: I cannot state the exact date, but I would say in 1934 or 1935.

The Court: Was there a period of several years when you didn't know who was the manager?

The Witness: I believe there was a period of about two years after Mr. Williams was fired, your Honor, that I didn't know who was the manager. I wasn't informed.

Q. (By Mr. Gardner): Now, who was the manager of the Chicago plant, if you know, sir, during the period 1931 to 1945? A. Carl Fulmer.

Q. Carl Fulmer. How long was he manager at that plant, sir, if you know?

A. I don't know, when Schalk first entered the field in Chicago. I don't know the date that they

(Testimony of Gerald I. Farman.)

went into Chicago, and opened a plant, but I believe Mr. Fulmer was with the company from the inception of its entry into Chicago and a little prior to that.

Q. I see. Was he employed under Horace O. Smith, or do you know?      A. Yes, he was. [226]

Q. That is Horace O. Smith, Sr.?

A. Sr., that is right.

Q. Yes. And how long, or what year, if you know, did Mr. Fulmer leave the company, or has he left it?

A. To my best recollection, I am not positive of this statement, it was 1949.

Q. When he left the company?      A. Yes.

Q. Was he manager of the Chicago plant at that time?

A. No, he was not. He had been transferred to Los Angeles to make a study, a research on market product production. He was quite an artist and he did a lot of very interesting art work for the packaging of Schalk.

Q. I see. When did he cease to be manager of the Chicago plant, sir, if you know?

A. That is a very difficult—it was during the 1948 that I transferred him out here. It would be very difficult to pin down the month, without the record, looking in the record.

Q. He was manager at the Chicago plant at the time you became president of Schalk, in 1948?

A. He was.

(Testimony of Gerald I. Farman.)

Q. One of your first acts was to remove him as manager of that plant; is that correct, sir?

A. I don't think it was one of my first acts. It [227] was in the general reorganization of the company that he was transferred out here.

Q. He was transferred?

A. And he was promoted when he was.

Q. He was promoted?           A. Yes; he was.

Q. Was he a good man?

A. Very good man on a lot of his ideas, a world of experience.

Q. All right, sir.

\* \* \*

Q. (By Mr. Gardner): Mr. Farman, when the recess came, I believe we were just finishing with the discussion on Mr. Fulmer. And I would like to get it absolutely clear as to the time during which Mr. Fulmer was manager of the Chicago plant, as far as you know, sir.

A. I first met Mr. Fulmer in 1926 or 1927, in Mr. Smith's home in Sierra Madre. He was manager at that time, and was manager up until the time that I transferred him, either in 1948 or '49, to Los Angeles.

Q. I see, sir, thank you.

Now, there is one other point I would like to get into before we get into further accounts of the corporation, and that is during the time you were chief of Naval [228] supply here. I believe you testified that—

Mr. Hall: Chief of supply, Corps of Engineers,

(Testimony of Gerald I. Farman.)

not Navy supply.

Mr. Gardner: Excuse me, sir.

Q. (By Mr. Gardner): What was your title?

A. I was chief of supply, Corps of Engineers, United States Army.

Q. Oh, United States Army?

A. Yes, sir.

Q. All right, sir. During that time, I believe you testified that you desired to purchase certain materials for Schalk Chemical Company?

A. Yes; right.

Q. And I believe you testified that you were turned down. What was the first occasion that you——

A. The first occasion that I recall, and I can be wrong because I don't recall the sequence, was when we built a house in Modesto, California, and the only flooring I could get was swamp hemlock. It is a part of the details only, and I wanted to bleach that floor and I knew the Double X was a terrific bleach, and I asked, or asked Mrs. Farman and I think I asked Bob later on for a shipment of 10,000.

I recall the amount because it was calculated [229] by the project engineer.

Q. What was the answer that you received, sir?

Mr. Hall: From whom?

The Witness: I was going to ask from whom?

Q. (By Mr. Gardner): What was the answer that you received from Mrs. Farman?

A. When Mrs. Farman told me that she took it up with Bob, and they didn't have the materials,

(Testimony of Gerald I. Farman.)

and I said, well, you explain to Bob that I will issue a priority for the materials.

Q. And then what happened, sir?

Mr. Hall: With regard to that order, Mr. Gardner, is that what you mean?

Mr. Gardner: Yes.

The Witness: Mr. Gardner, I can only answer it this way: That soon after that I made it a personal, I wanted the materials. I was not thinking of Schalk. I made it a personal point on one of my trips to go down and see Lieben and ask him for the materials.

He said he wasn't interested in supplying the Government with any materials, and I recall——

Q. Who is he, sir?

A. I said Mr. Lieben.

Q. Oh, Lieben, excuse me, sir. Mr. Lieben [230] stated what, sir?

A. Mr. Lieben stated that he wasn't interested in supplying the Government, and that he wanted all his, he wanted all of the materials they were able to make to go to consumers.

Q. Now, at that time, do you know whether or not Schalk was having difficulty obtaining employees?

A. Well, the answer to that question, all companies were having difficulty in hiring employees, because they were being drafted as fast as——

Q. So, it was rather a difficult situation?

A. It was, yes, it was; it would be.

Q. Actually, many companies, including Schalk,

(Testimony of Gerald I. Farman.)

could have done a much larger business had they had the employees, couldn't they?

A. Oh, there is no doubt, sir.

Q. Now, the second time that you contacted Schalk, sir, was when?

A. It was shortly, it was during this period, it was shortly after I asked, Mrs. Farman asked Bob for it. At that time, I also saw Bob and told Bob that I needed this material very badly. It was imperative that I get a similar, get this material or similar material, and that I would give him a priority with a ten per cent cushion in it to furnish the material. And he said, well, he wasn't [231] interested in the order.

Q. Now, could the reason, as you well know at that time, there was also difficulty of obtaining employees, wasn't there?

A. Mr. Gardner, that is true. I am going to add something.

Q. That is true?           A. If I may——

Q. You may, oh, surely.

A. I may. The formulation of Double X is a very, very simple matter. Mr. Smith was working in the factory, himself, most of the time, I believe, and Mr. Smith could have easily formulated the amount that I wanted in a very short period of time. It was bulk material that I wanted.

Q. I see. But supposing the plant was operating at capacity, that is Mr. Smith himself, the president was working in the plant, that should indicate to you that they were using their manpower to the ultimate, wouldn't it?

(Testimony of Gerald I. Farman.)

A. Not necessarily, no. Mr. Smith enjoyed the factory arrangement; told me he did.

Q. But, in any event, the president was actually working in the plant during this time; wasn't he?

A. He was from time to time.

Mr. Hall: During what time, Mr. Gardner?

Mr. Gardner: If you will keep current with the [232] questions, sir, you will know this is the time that he, that the witness was ordering or attempting to order supplies from Schalk for his—what was that, the Army, you say, Mr. Witness?

The Witness: The Corps of Engineers, United States Army, War Department.

Q. (By Mr. Gardner): All right, sir. Now, then, we will get into the corporation.

Do you know, or do you recall whether or not dividends were declared in the year 1942, sir?

A. I could not recall definitely that they were. They were declared, I believe, under the trust agreement. I believe there was. There is a stipulation that they would declare dividends whenever possible.

Q. Well, now, do you know whether that was carried out during 1942?

A. I can't specifically say. I didn't receive the dividend, so I couldn't specifically say.

Q. Were you present?

A. I have records of those. If I could bring my records up, I have records of all the dividends paid.

Mr. Hall: Your Honor, we have them. Mr. Gardner has in evidence the audit reports from



(Testimony of Gerald I. Farman.)

1942 to 1946; also Petitioners have in evidence the audit report of 1947, [233] which reports show whether there were or were not dividends.

Mr. Gardner: May I have the reports, your Honor?

Q. (By Mr. Gardner): In order to save time, Mr. Farman, I will read to you from these exhibits the dividends declared as to each of the years.

Mr. Hall: Your Honor, would Counsel please state the reason for reading from the exhibits which are in evidence?

Mr. Gardner: This is for the purpose, your Honor, for further questions of this witness.

Mr. Hall: Regarding dividends?

Mr. Gardner: Regarding dividends; yes, sir.

Q. (By Mr. Gardner): Exhibit D, for the year 1942, shows dividend paid of \$10,000.

Exhibit E, for the year 1943, audit report shows dividends of \$17,500.

Exhibit F, audit report for the year 1944, shows dividends declared of \$15,000.

Exhibit G, audit report for 1945, shows dividends declared of \$15,000.

Exhibit H, audit report for 1946, shows dividends declared of \$57,000.

Now, when you first came to the Schalk Chemical Company in 1945, I believe you stated you were expediter? [234] A. That is correct.

Q. And were you also a member of the board of directors? A. No, not in 1945.

(Testimony of Gerald I. Farman.)

Q. I see. Did you subsequently become a member?           A. I did, in 1946.

Q. In 1946. Now——

Mr. Hall: Your Honor, it is stipulated by the Government that he became a director in '45.

The Witness: I am sorry.

Mr. Hall: I believe Mr. Farman is just mixed up.

Mr. Gardner: I make no issue of that.

The Witness: I will assure you I didn't recall it.

Q. (By Mr. Gardner): I made no effort to trap you, or anything like that. If it was 1945, the record will show that. I realize that was some time back, sir.

Now, I wasn't quite sure from your testimony as to just when you became alarmed at the management of the corporation. Could you tell me when that was, sir?

A. I would like to ask you which management of the corporation, the Smith management, or the Colyear management?

Q. All right, sir. Let's go back to the very beginning then, sir; when did you first become alarmed [235] at the management of Schalk Chemical Company?

A. In 1931, when I married Mrs. Farman, soon after that.

Q. You became alarmed?           A. I did.

Q. Would you tell the Court your reason for being alarmed, sir?

(Testimony of Gerald I. Farman.)

A. Mr. Colyear presented to Mrs. Farman, in my presence, an employment contract, which in my—to my best judgment was the most absurd thing that could be asked of a company.

It required, it demanded a salary and——

Q. Excuse me, sir.

A. The employment contract incorporated a salary and a percentage of the profit.

Q. To whom was the employment contract?

A. With the Schalk Chemical Company.

Q. Who was to be employed?

A. Mr. Colyear's contract. I am sorry, I didn't make that clear.

Q. Mr. Colyear's. All right, sir.

A. It was quite alarming.

Q. It was quite alarming to you, sir?

A. Yes, sir.

Q. All right. What else? [236]

A. Well, during the years from '31 to 1940, the supervision of Schalk Chemical Company by Mr. Colyear was based on an attitude of holding the company, not progressing, but holding it intact, because it being a trust, I believed that his statements were that all I am interested in doing is holding the trust intact, is not advancing the Schalk Chemical Company.

Q. All right, sir. What else alarmed you?

A. Well, as I stated, if I may refer to my book, I could get it correct. I believe it was 1939, a product I mentioned, Hydro Pura, the sale of Hydro Pura at one time when I first knew the Schalk Chemical Company was \$270,000.

(Testimony of Gerald I. Farman.)

Sales had dwindled during this period that I will refer to as the '39 period, 1938-39 period, it dwindled down to about \$14,000. I have that figure; I quoted out of my notebook.

The main leads in the line, and the big profit item, and the product that was carrying the Schalk Chemical Company was Double X, and I stated in my testimony yesterday, that Double X had slid, was sliding fast, and I also tried to explain that a lot of that was due to the fact that electric sanders were introduced during those periods.

Q. Electric sanders? [237] A. Yes.

Q. Now then, did you ever tell Mr. Colyear you didn't approve of his management?

A. Mr. Colyear, because I was asked by my wife, and would naturally do it when Mr. Colyear presented his contract for employees. I asked Mr. Colyear a very short and pointed question, "Can Schalk stand this type, or this amount of money?" And he immediately became enraged, and walked away.

From then on I didn't see Mr. Colyear up to, for the rest of his life.

Q. You never did see him again?

A. After that.

Q. Did you ever, now that we have talked about this a little bit, did you ever go down and contact anyone at the Schalk Chemical Company?

A. I did. I said up to the time of his death, Mr.—

Q. Yes.

A. I didn't during that time, to my knowledge, no.

(Testimony of Gerald I. Farman.)

Q. In other words, you didn't set foot in Schalk Chemical Company?

A. Not to my knowledge. Mrs. Farman received yearly financial statements. I always studied those with her, explained them to her, as well as I could.

Q. Did you attend the board meetings with her? [238]

A. I did, from time to time, not every time, sir.

Q. Now, where were the board meetings held, sir?

A. In Mr. Wackerbarth's office, here in Los Angeles.

Q. Wackerbarth?           A. Wackerbarth.

Q. Was Mr. Colyear present at some of those meetings?

A. That is a hard question for me to answer. He would be present if he was in town. I am sure he wouldn't call a meeting without being present.

Q. You didn't mean that exactly, when you said you didn't see him again?

A. I should retract that statement. I was thinking in terms of going to see Mr. Colyear and not actually the meetings with Mr. Colyear.

Q. At the board meetings, during the period 1931 to 1942, did you take an active part in those meetings, sir?           A. I was not a director.

Q. Did you ever say anything in those meetings?

A. It would be very hard to recall, sir.

Q. All right. Now then, we are up to—was there anything else that bothered you about Mr. Col-

(Testimony of Gerald I. Farman.)

year's management with the, of the firm, up to 1942?

A. Well, the principal thing that no new products, research. There were new products introduced during the [239] period, two of them, but no research, no attempt to further Schalk's interest in advancement in the field that they were in, sir.

Q. I see. Now then, I take it we have exhausted your reasons for your dissatisfaction with the management?

A. There is one time in 1940, he was still president, that there was a loss that was of great concern, but it was the pattern, predicted pattern, pattern predicted by me that would happen, that this continued holding the straight line meant deterioration of Schalk. I made that statement many times.

Q. I see. Did you inform your wife of this?

A. I did.

Q. Did she inform Mr. Colyear of this at the board meetings?

A. She did at director's meetings.

Q. She, in effect, told Mr. Colyear what you had told her; is that correct, sir?

A. I believe that is probably correct.

Q. You advised your wife all during the period of the trust; didn't you, sir?      A. I did.

Q. But, and she relied on your judgment, didn't she?      A. I hope so. [240]

Q. You advised the daughters also, didn't you, sir?      A. I did.

Q. And they relied on your judgment?

(Testimony of Gerald I. Farman.)

A. I hope so. I think they did.

Q. Now, does that exhaust the reasons for your dissatisfaction with the management of Schalk up to 1942?

A. Well, I realize that this question is a very pertinent one. I don't recall. It is very hard for me to recall the small or large, or major, the two major things were that Mr. Colyear's statement to Mrs. Farman was that he was not interested in furthering Schalk's advancement, that he was supervisor of the trust, and that all he cared to do was hold the company intact for up until the trust, to the duration of the trust.

Q. I don't want to argue with you, Mr. Farman, but that seems like an extremely stupid statement for a good businessman to make, and I believe you have testified that he was a good businessman.

A. I didn't testify. He had the reputation of being a good businessman.

Q. And he made a stupid statement like that, sir?

A. He made that statement on several occasions.

Q. That he was not interested in——

A. In furthering the advancement of Schalk. He was interested in holding the trust intact, to its duration, which caused the whole family great concern, I will assure [241] you.

Q. I see, sir. Now, going to the management of Schalk for the period 1943 on, until the president and supervisor, Horace Smith, Jr., stepped out in 1948——

(Testimony of Gerald I. Farman.)

Mr. Hall: It is stipulated, Mr. Gardner, that Mr. Smith became president in 1942.

Mr. Gardner: Yes, he became president in '42, became supervisor in '43, did he not?

Mr. Hall: He did. You asked from '43 on. I just wanted to be sure the witness understood your question.

Q. (By Mr. Gardner): My question goes from 1943. A. What is it, end of 1943?

Q. Up until the time that Mr. Smith, Jr., left the corporation? A. Okay.

Q. When did you first become dissatisfied with Horace Smith, Jr.'s, management?

A. Well, I became alarmed during the period that I mentioned, when I couldn't buy war materials that were essential to the war effort from Schalk. I couldn't understand that, and was very alarmed over it, over the thing.

Q. I see, sir. And when next did you become alarmed? [242]

A. Well, when Mr. Smith, Jr.'s, mother offered suggestions for new products, and Mr. Smith refused to accept any of her suggestions, and also offered suggestions in the packaging of our products.

Q. Now, these suggestions were whose suggestions, sir?

A. They were Mrs. Farman's suggestions.

Q. Were they your suggestions to Mrs. Farman?

A. I would say a very small percentage of them



(Testimony of Gerald I. Farman.)

would be my suggestions. I was very busy man, working 18 hours a day, and I didn't have time to fool around with too many suggestions.

Q. I see. Now, at about what year did this occur?

A. Well, you mentioned the years of 1942 through 1947, and I have made that statement in general. That it was during those years, the early part of it was 1943 and 1944, that Mrs. Farman was, started to enter into new product field. I can't strike down a date. I can give you two years.

Q. All right. What were the two years?

A. 1943 and 1944.

Q. All right. Now then, we are up to 1944; in other words, was there anything in 1945 that caused you alarm, sir?

A. Well, the greatest alarm during 1945 was the [243] fact which I testified to, when I was employed in September as an expeditor, and went to Chicago with Mr. Smith, and found that their factory was virtually shut down because of lack of materials.

Q. That is the exact job you were hired to do, wasn't it?      A. That is right.

Q. So you were doing nothing more than what you were hired to do?      A. That is right.

Q. But you were alarmed then?

A. I was hired for that in 1945, and I was alarmed at that time.

Q. All right, sir. Now, when was the next time you were alarmed?

(Testimony of Gerald I. Farman.)

A. Well, I was alarmed when in 1945 we set up an executive committee, which Mr. Smith proceeded to ignore. This executive committee was set up to manage, and manage the Schalk Chemical Company, and Mr. Smith proceeded, at the very inception of it, of the signing of the agreement to ignore it.

Now, what in management were you dissatisfied with during that period, sir?

A. Lack of research, market research and lack of new product research. [244]

Q. I see. And well—go ahead.

A. There is nothing being done during that period in 1945, that I mentioned, from September towards improving the products. They had a food chemist on a retainer fee at \$300 a month that was doing nothing. He was a food chemist, a very fine food chemist, but he was not familiar with the organic chemicals or the chemicals used by Schalk Chemical Company.

He also probably was, in fact, I went over to see him several times. He was supposed to introduce new products, which he didn't do.

Q. What about the financial structure of the company at this time, were you pleased with that, or dissatisfied?      A. In 1945?

Q. Yes.

A. That was never a part of the controversy that I recall.

Q. All right, sir. Let's get up to 1946 then.

What about the financial structure of the company at that time; were you satisfied with it?

(Testimony of Gerald I. Farman.)

A. I made a report to the executive committee that the products that we were shipping that we had been able to purchase materials with orders that dated back as far as June, 1945, and I said this 1946 is a very inflated year, it has no, it is no yardstick for measurement at all. [245]

Q. I see. Was it in 1946—I believe you testified it was some time in 1946 which you became quite alarmed, and attempted to at least discuss with Horace Smith, Jr., the possibility of his stepping out as president and supervisor.

A. The fact that Mr. Smith refused to co-operate in any way with the family, the family being Mrs. Farman and Mrs. Farman's two daughters, Mrs. Marlow and Mrs. Baker, and refused, actually both girls were married at that time, and refused to co-operate, or listen to their husbands in any way, shape or form. It was quite alarming to the whole family.

Q. And the whole family wanted him out in 1946; is that correct, sir?

A. I don't believe that that came up in 1946, Mr. Gardner.

Q. You mean you wanted him to be supervisor in 1946, sir?

A. No. We wanted him to resign as supervisor, during 1946, but remain in the company.

Q. Now, when did you first discuss with him the possibility of resigning as supervisor, Mr. Farman?

A. I will make it broad; during the years of 1946 and 1947.

(Testimony of Gerald I. Farman.)

Q. During the early part of 1946? [246]

A. I wouldn't say the early part; during the year of 1946 and 1947.

Q. Excuse me, sir. When was the executive committee set up?

A. In September or October, 1945.

Q. I believe you testified that it was immediately a failure?           A. Yes, sir.

Q. Did your desire to have Mr. Smith removed as supervisor stem from that?

A. That was only one part of the complete picture.

Q. But in any event, from that time on, you wanted him out of there?

A. Not from that time on.

Q. From what time?

A. The build-up of many things that have been testified to, the lack of research, market research. I have gone over this, the lack of any interest of new products, the lack of market research.

There was a combination of many things that caused concern in the family.

Q. In the family. And this concern was apparent as early as 1945, was it not, sir?

A. Yes, it was. It was, prior to that even.

Q. In fact, you might say the concern of the family [247] started back in 1931, wouldn't you, as to the management of this business?

A. I would not say that, no.

I said that when Mr. Colyear presented an employment contract, it caused a very unsatisfactory,

(Testimony of Gerald I. Farman.)

caused dissension. Let me put it that way, please.

Q. All right, sir. Now, let's get on up into 1947.

Well, wait a minute. Let's go back to '46 again. You have testified that the sales for that year were inflated?

A. Yes, sir.

Q. Because you had back sales, or back orders that you were filling? Other than that, what about the financial picture of the corporation?

A. Well, I was made vice president and had an active part in many financial arrangements during 1946, but that I believe with, had at least a small part of it, served in a small way, the success, financial success during that year.

Q. I see. Was the company financially sound at the end of the year, sir?

A. The company was financially sound, if in your—on the basis of the financial statement only.

Q. What was wrong with it? [248]

A. We had outgrown—we had not—I retract the word outgrown—we did not have proper facilities in Chicago to develop products that were being marketed by competitors during that period, and we were not doing anything during that period to build a solid firm company for the future.

Q. Now then, let's get into the year 1947. Apparently the members of the family must have become very alarmed in the early part of '47. I say that, having in mind the action that was instituted on behalf of them.

Mr. Hall: Would you mind talking a little louder, please, Mr. Gardner?

(Testimony of Gerald I. Farman.)

Mr. Gardner: I am sorry.

Q. (By Mr. Gardner): The action that was instituted on behalf of the family to have Horace Smith, Jr., removed as supervisor. Now, could you tell me, sir, when did these discussions relating to the action, itself, begin?

A. I could not tell you the exact date, and be correct. I would say it was from—came up yesterday, and I was unable to answer it—it was after, during the spring months, or the summer months.

I couldn't answer that, because it is a hard thing for me to remember back. Specific dates, I have no records of any. [249]

Q. Well, the action was apparently filed in April of 1947, so that should help you pinpoint it, at least.

A. I recall that yesterday that was also mentioned. But this action was the outcome of at least one full year of 1946.

Q. It went clear back to the whole year of '46?

A. I imagine it did.

Q. I see, sir.

A. It would be my idea, because nothing could be done.

Q. Well now, was there anything startling in these monthly statements that you looked at for 1947? A. Nothing at all. It bore economy.

Q. 1947, sir?

A. Oh, 1947, I am sorry. Startling thing is the loss.

Q. Loss. Did the company have any cash on hand, sir; did the company have any cash on hand?

(Testimony of Gerald I. Farman.)

A. At the end of the year, their cash was depleted.

Q. At the end of the year '47?

A. Yes. I say it wasn't depleted; it was below the point of being sound.

Q. In fact, at the beginning of the year, it wasn't very good, either, was it? [250]

A. I would have to see the statement. I am sorry. I could tell you.

Q. Well, was that one of the reasons that you had some concern about this corporation, the fact that they didn't have any working capital and were borrowing money?

A. Not necessarily. I borrowed money when my capital was low.

Q. I seem to recall that you looked at one of these audit reports here, sir, and expressed some concern over a \$15,000.

A. That was a \$15,000 note.

Q. Would you explain what that concern was?

A. Well, I will have to explain it in my way, Mr. Gardner.

My prediction was, to begin with, that I—this is my opinion that I stated yesterday—that the company could not stand, could not weather two years loss in going, at the end of 1947 the working capital had been depleted, and in 19—the end of 1947, there was a note of \$15,000 owing to the bank, which would naturally be a factor in borrowing more money.

(Testimony of Gerald I. Farman.)

Q. Now, this actually was a sort of thing you had been predicting all along, wasn't it?

A. I predicted without a, without a program that Schalk could not survive. [251]

Q. And you had been predicting that in 1946, hadn't you, sir; this is just kind of fulfillment of the prediction you had been making?

A. I imagine that you may say it that way. [252]

\* \* \*

Afternoon Session—1:30 P.M.

### GERALD I. FARMAN

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Mr. Gardner: Can I have this marked for identification as Respondent's next in order, [253] please?

\* \* \*

The Clerk: Respondent's Exhibit J for identification.

(The document above referred to was marked Respondent's Exhibit J for identification.)



(Testimony of Gerald I. Farman.)

Cross-Examination  
(Continued)

By Mr. Gardner:

Q. Mr. Farman, I show you what has been marked Respondent's Exhibit J for identification, and ask you to examine that book, and state whether or not that contains the minutes of the board of directors for the Schalk Company?

A. It is the minute book of the Schalk Chemical Company.

Q. It is the minute book, sir; all right, sir.

At this time, I offer this document in evidence, your Honor. [254]

\* \* \*

The Clerk: That is Exhibit J.

(The document heretofore marked for identification as Respondent's Exhibit J, was received in evidence.) [258]

\* \* \*

Q. (By Mr. Gardner): Mr. Farman, referring to Exhibit J, page 283 thereof, at the top of the page, it stated the minutes of the adjourned meeting of board of directors of Schalk Chemical Company, and the date is 27th day of December, 1946.

I see on this document also that G. I. Farman was present as a director; is that correct, sir?

A. That is correct.

Q. You were there on that date?

A. I remember that date very well; yes, sir.

(Testimony of Gerald I. Farman.)

Q. You do, sir? Now, going down to the bottom of page 283, and I quote:

“After a considerable discussion with reference to the amount of dividend to be declared, Director G. I. Farman, presented the following resolution and moved its adoption:

“Resolved: That a dividend of \$42,000 be, at the rate of 42 cents a share, out of the net profits of this corporation, earned during the calendar year 1956, be, and the same is hereby declared, and that the same be immediately paid out and distributed to the shareholders of [260] record of said corporation, on this the 27th day of December, 1946.”

Do you recall making that resolution, sir?

A. I recall the instant. To begin with, Mr. Smith proposed a dividend in the amount of \$42,000 accompanied with a letter from Mr. Rauch, which letter is a matter of record, that we had to pay out 70 per cent. I think it comes under provision 102, Internal Revenue Laws, 70 per cent of our—if I fumbled that part, I am sorry—70 per cent of our earnings.

I recall so well my statement. I said if we have to do it, I would make the resolution, but I would like to hold off for a few days to investigate the necessity of paying this dividend.

I objected seriously because I wanted to plow back; first purchase the property, next door, which was available at a very reasonable figure for expansion; number two, I wanted to buy automatic equipment.

(Testimony of Gerald I. Farman.)

I did not write these minutes, so I will not swear to their authenticity.

Q. Is it your statement, sir, that the minutes are not correct?

A. I didn't write the minutes. I will not swear to their authenticity. I do not recall making that motion. I gave a proviso in my recommendation. [261]

Q. Well, let's continue with this exhibit just a little but further, that is referring to Exhibit J, page 284, near the top of the page.

"Thereupon, G. I. Farman brought up the matter of an additional bonus to the executive officers in accordance with the discussion held at the meeting of December 16, 1946. After some discussion, Director G. I. Farman presented the following resolution, and moved its adoption:

"Resolved: That a bonus in the sum of \$1,200 be paid to the president, Horace O. Smith, Jr., and a bonus in the sum of \$1,200 be paid to each of the vice presidents, Hazel Farman, and G. I. Farman, as an additional salaries for their services performed during the year 1946."

Do you recall making that resolution, sir?

A. I do not directly recall it. I don't remember it at all.

Q. Is it your statement that you did not make the resolution, sir?

A. I did not state that, Mr. Gardner. I said I do not recall making the resolution.

Q. Thank you; thank you.

In any event, making such a resolution would be directly contrary to your policies as you have ex-

(Testimony of Gerald I. Farman.)

pressed them; that is, they should be plowed back into the [262] corporation, isn't that correct, sir?

A. That was a very small amount of the earnings for that year. I believe it amounted to \$1,200 each, or total amount of \$3,600, to be paid to the three executives or the three members of the executive committee.

Q. But the \$42,000 dividend was rather sizeable, was it not, sir?

A. It was a very sizeable dividend.

Q. Yes.

A. I would like to go on record that I bitterly and Mrs. Farman bitterly opposed the paying of that dividend. We begged them not to, and they railroaded it through because they controlled the board.

Q. Might I inquire, sir, was the resolution to pay the \$42,000 your resolution?

A. I said I did not write the minutes. I recall the instant very clearly, where Mr. Smith recommended, on Mr. Rauch's letter, that the dividend be paid. And I recall very definitely, if we had to pay the dividend, I would naturally have to go along with it.

But I asked for time to investigate whether we had to make, pay the dividend, and I did investigate, and incidentally, prior to anything, any of my investigation, the dividend was railroaded through by Mr. Smith and his two—I call them—yes-men. [263]

The Court: Did you vote for or against it?

The Witness: I voted against it. Mrs. Farman voted against it. We definitely know that.

(Testimony of Gerald I. Farman.)

Q. (By Mr. Gardner): Is it your testimony then, sir, that these minutes relating to the Exhibit J, page 283, 284, relating to the meeting of the board of directors of the Schalk Company, 27th day of December, 1946, are incorrect?

A. I will not make a direct statement there.

Q. Just yes or no.

A. I will not say they are incorrect. I may say they are not complete. They were not written by me and I had nothing to do with it.

Q. But you would not say they are incorrect?

A. I will not say they are incorrect. I would not make a misstatement of fact. I don't know.

I would say they are not complete, that they don't bring out the fact that Mrs. Farman and I bitterly opposed it.

Q. You can read the document, Mr. Farman.

A. I had time to read the whole thing, but it is neither here nor there, but I said if it does not bring out the fact that when Mrs. Farman and I opposed this, at that meeting, or a meeting following it, the minutes are not complete. I will say they are incorrect and not [264] complete.

Q. They are not complete. They are accurate as far as they go?           A. I don't know.

Mr. Hall: Your Honor, I object to continued questioning on this. The witness has stated his position.

As the court knows, and Mr. Gardner knows, minutes are traditionally prepared by attorneys interested with the parties, and most often do not re-

(Testimony of Gerald I. Farman.)

flect every conversation in every matter that is discussed at a meeting. The minutes reflect the opinion of the author of the minutes, as to what should appear in the minutes. And it is the attorney who prepares them that often decides what should appear in the minutes.

Now, Mr. Farman has answered the question two or three times, to the best of his recollection, that he didn't make the motion.

The Court: Do the minutes reflect who voted for or against the resolution?

Mr. Gardner: Yes, your Honor. I read at page 284, Exhibit J.

“The motion to adopt said resolution—that is relating to the \$42,000 made by Mr. Farman”—was seconded by Hazel Farman and upon being presented to the board, was adopted by the affirmative vote of all directors [265] present.

The Court: Mr. Farman, is it your testimony that that is an untruthful statement?

The Witness: It is my testimony that Mrs. Farman and I bitterly opposed it.

The Court: That is not being responsive.

The Witness: I am sorry.

The Court: It is not responsive to my question.

The Witness: Pardon?

The Court: I want to know whether you voted for or against the resolution?

The Witness: I voted against the resolution.

The Court: Then is it your testimony that that statement in the minutes is untruthful?

(Testimony of Gerald I. Farman.)

The Witness: It is.

Q. (By Mr. Gardner): Is it also your testimony, sir, that the statement in the minutes relating to the resolution, that is the presentation by G. I. Farman, that the \$42,000 dividend be declared, is that also untruthful, sir?

A. I have answered it that I do not recall making the statement. I answered it exactly the way I recalled it, that if Mr. Rausch, in his letter is correct, we will have to pay them. I asked for time and I investigated and found that we did not. [266]

Q. May I interrupt, sir? I am only asking whether or not you did make the resolution, sir?

A. I have answered it.

Q. How did you answer? Did you make the resolution, sir?

A. To my best recollection I did not make a resolution.

Q. But you may have?

A. I stated, Mr. Gardner, that I recall the instant very well, and stated at the directors' meeting that if Mr. Rausch is correct, we will have to pay a dividend, period.

Q. Well now, you have testified just now to something that might be a little different. If you have to pay the dividend, why did you bitterly oppose it?

A. Because I didn't feel we had to pay the dividend, and asked for a time to investigate, and I took the time and came back to the board and stated we did not have to pay the dividend.

Q. You stated to the board you did not have to

(Testimony of Gerald I. Farman.)

pay the dividend?           A. That is correct.

Q. When did you make that statement to the board, sir?

A. Why, in January, at the—at some meeting in January. [267]

Q. Some meeting in January of what year, sir?

A. 1947.

Q. All right, sir.

A. May I retract that statement? I made that statement to Horace O. Smith, Jr., the president, that I had investigated it and I would be glad to go on record who I talked to in regard to that matter.

Q. Well now, did you or didn't you—excuse me.

A. That we did not have to pay the dividend, and the proper thing would be to plow in, to increase our facilities in Chicago, by land with the—

Q. Now, did you so inform the board of directors?

A. I don't recall that, Mr. Gardner. I recall going to Mr. Smith about it.

Q. As a natural matter of fact, you didn't have a board of directors' meeting in January of '47, did you?

A. I don't know. You have got the minute book.

Mr. Hall: Well, Mr. Gardner, it shows there was one in February, '47, does it not?

Mr. Gardner: There was one in February, yes.

Q. (By Mr. Gardner): As I understand your testimony right now, is to the effect that you did not



(Testimony of Gerald I. Farman.)

inform the board of directors that they did not have to pay this dividend; is that correct, sir? [268]

A. That is correct. I will also state that I also informed my wife, and Mrs. Farman's two daughters, and their husbands, that we did not have to pay the dividend.

Q. But you never did inform the board of directors?

A. I don't believe I did. It would have been useless to do it. The board is controlled by Bob Smith, and would have had no effect on the board. They had already railroaded it through, any way.

Q. I see.

The Court: If you say you did not present the resolution, who did?

The Witness: The matter, your Honor, was presented by Mr. Smith originally, to pay a [269] dividend.

\* \* \*

Q. (By Mr. Gardner): Mr. Farman, referring once again to Exhibit J, going to page 280 thereof, and specifically to the meeting of the board of directors of Schalk Chemical Company on the 16th day of December, 1946, do you recall being present at that meeting, sir, as a director?

A. Yes, I was there. I had to read far enough to identify it.

Q. You take your time, sir.

Now, going over to page 281, at the bottom of the page, would you read beginning with that second line from the bottom?

A. You want me to read this out loud, sir?

(Testimony of Gerald I. Farman.)

Q. Would you, sir?

A. Yes. "Director G. I. Farman called the attention of the board to the fact that he had contracted an indebtedness of \$16,000 for automatic filling machine and automatic crack filler. He also suggested that it would be advisable to purchase the automatic filling machine for hand pound packages of Savabrush and that such a machine would cost approximately \$8,000 installed."

Far enough?

Q. Very good, sir. Thank you.

Now, do you remember whether or not the \$8,000—

A. Pardon me. May I see those minutes once more? [270]

Q. Surley. The witness is now examining Exhibit J.

A. I have had enough. Thank you.

Q. Do you recall whether or not the automatic filling machine which you suggested be purchased at a cost of \$8,000 was ever purchased?

A. I do, yes. The minutes are incorrect, but it is an error in probably transposing or something.

Q. All right, sir.

A. It says a crack filling machine, does it not?

Q. It says an automatic filling machine for half pound packages of Savabrush.

A. For half pound Savabrush. That is incorrect. I am sorry. But it is incorrect.

I recall buying an automatic machine, or not buying an automatic machine. I didn't buy the ma-

(Testimony of Gerald I. Farman.)

chine, I recommended the purchase of the machine. I did not buy the machine.

Q. Do you know whether or not the machine was purchased?

A. The machine was purchased, yes.

Q. The machine was purchased. All right, sir.

Do you recall where that machine was installed, here or in Chicago?

A. The machine was not installed until I went in in 1948. It set for one full year at least, at least one full year, in the crate. It was never installed until I was, [271] went in as president after January 15, 1948.

Q. Was the machine in Chicago, or was it in Los Angeles?

A. It was in Chicago. I think, if I may ask, that when I had this machine—so we are not talking about two different machines—I am talking about an automatic pneumatic scales machine for filling three ounce Waxoff. You see, the minutes confuse me, sir.

Q. I see.

A. The purchase price is approximately correct, \$8,000 on the machine I am talking about.

Q. \$8,000. And that machine was not used, you say?

A. It was not installed until after January 15, 1948.

The Court: Were there other automatic machines that were installed and used prior to that time?

A. That was the first piece of automatic equip-

(Testimony of Gerald I. Farman.)

ment that the company ever purchased for the Chicago plant.

The Court: Was there any piece of automatic equipment purchased and used in either plant, prior to your becoming president?

The Witness: The Los Angeles plant had a pneumatic scales packaging machine for Hydro Pura for as long as I have known the company, which dates back to 1921. That machine was installed at that time, or before my time. [272]

The Court: And that was the only one?

The Witness: Yes, sir.

The Court: Prior to the new machine that was installed after you became president?

The Witness: May I qualify this, please, your Honor?

It is the first fully automatic I purchased, or caused to be purchased, two semi-automatic machines operated by people in 1946. I testified to that yesterday. This is fully automatic that we are talking about.

The Court: Were these semi-automatic machines in use prior to your becoming president?

The Witness: No, sir. Oh, pardon me. No, I misunderstood.

Yes, these two machines were put in service in 1946.

The Court: In Chicago, or——

The Witness: In Chicago; yes, sir.

The Court: Is that as a consequence of your visit to the Chicago plant?

(Testimony of Gerald I. Farman.)

The Witness: It was, sir.

The Court: Have you made any recommendations in respect to packaging for the Chicago plant that were not adopted in 1946?

The Witness: I recommended that we purchase all automatic equipment, inasmuch as we had made quite a bit [273] of money, and I wanted to plow it into automatic equipment, sir. And this one particular machine was purchased either by Mr. Smith or by Mr. Fulmer, the manager there. I recommended its purchase, investigated and recommended its purchase, but I also recommended that we buy all automatic equipment.

Q. (By Mr. Gardner): While we are on the subject of the Chicago plant, I believe you testified, Mr. Farman, that in some period you desired to obtain additional quarters for that plant so that you may enlarge? A. That is right.

Q. And when was that?

A. During 1946 a plant became, was—become available in one block from our present plant, the corner of 47th Street and Christiana, and it was known as the Philco Building.

It was built by the Philco Company that was available and presented to us for purchase. Mrs. Farman and I were both in Chicago, inspected the plant, and called Mr. Smith on the phone and recommended the purchase of this building. The purchase price was \$118,000.

Q. \$118,000. Now, from that time, sir, up to the

(Testimony of Gerald I. Farman.)

present time, have the facilities in the Chicago plant——

A. Will you pardon me, I cannot hear you. [274]

Q. Excuse me, sir.

A. You turn your back and I miss it.

Q. From the time that you made your recommendation that the additional building be purchased, that was in 1946 you said?

A. Yes, sir.

Q. To the present time, would you state just how the facilities in the Chicago plant have been enlarged?

A. The facilities in the Chicago plant have not been enlarged. In 1948, when we took—I was made president of the Schalk Chemical Company, the corporation owed money, and it was always, and in all of our proposals, the intent of the family that the corporation should pay off the \$45,000 to Mr. Smith. It was always proposed, in many cases proposed, in every case proposed that the family would loan the money to the corporation, because the corporation was short of money, that they would loan the money to the corporation on the basis that the corporation would pay them back, to pay off Mr. Smith.

We did not have the money to expand our plant, and had been plowing in as much as we could, to acquire the land. Inflation has taken hold, as we are all familiar with it, and properties that we could have purchased back in 1946, land alone at 75 or even 60, was the price of the property next to us.

(Testimony of Gerald I. Farman.)

It is now worth dollar and a half. [275] It is not for sale, but that is the appraised value.

Q. In other words, in 1946, you thought it was advisable to incur an obligation of approximately \$118,000? A. \$118,000, I recommended it.

Q. You recommended it?

A. Yes, sir. [276]

\* \* \*

The Clerk: Respondent's Exhibit K for identification.

(The document above referred to was marked Respondent's Exhibit K for identification.)

Q. (By Mr. Gardner): Mr. Farman, would you examine Respondent's Exhibit K for [277] identification— A. Minute books.

Q. —and see if you can identify that exhibit, sir? Just the document in general, please, sir.

A. Well, I had to read the document to know.

Q. I see, sir.

A. To know what it contained. You want me to identify this document?

Q. Yes.

A. The entire book here, the book is a minute book.

Q. The book is the minute book? A. Yes.

Q. That is Exhibit K?

A. Exhibit K is the minute book of the Schalk Chemical Company.

Mr. Hall: Volume V.

The Witness: Volume V.

Mr. Gardner: Volume V, yes.

(Testimony of Gerald I. Farman.)

The Court: Covering what period?

Mr. Gardner: Covering the period April 17, 1947 to January 16, 1952.

Q. (By Mr. Gardner): Is that correct, sir?

A. Is that the latest? Let me look. Yes, sir, that is correct.

Q. Going to page 60 of Exhibit K, the date December [278] 15, 1950, do you recall being at a special meeting of the board of directors of Schalk Chemical Company, sir?

Mr. Hall: Your Honor, the witness is reading from Exhibit 5 attached to the stipulation.

Mr. Gardner: Yes, Exhibit 5, your Honor, of the stipulation.

The Witness: Yes, I recall this meeting.

Q. (By Mr. Gardner): You were present, sir?

A. Yes, sir.

Q. Now, this is after you had been in control of the corporation from what is it, January of 1948, to this time, sir?

A. Yes, sir.

Q. In 1946, at the time you recommended the acquisition of additional property in Chicago, could you tell us what time of the year that was; was that the latter part of the year?

A. I am sorry, I didn't get your question, Mr. Gardner.

Q. All right, sir. I believe you stated that in 1946 you made a recommendation that Schalk Chemical Company purchase additional property in Chicago?

A. Right.



(Testimony of Gerald I. Farman.)

Q. Now, could you state what time of the year that [279] was in 1946?

A. I could not. I made two recommendations in 1946 to purchase property, and I couldn't tell you the time of the year of either one. One was a recommendation that we buy the adjoining property at 60 cents a square foot; the other one was the Philco Building, known as the Philco Building at the corner of 47th and Christiana.

Q. Now, what was the cost, approximate cost of the Philco Building?

A. \$118,000.

Q. And what was the approximate cost of the other building, sir?

A. The other building was not a building. It was vacant land at 60 cents a square foot adjoining our plant.

Q. I see. And how much would that have cost?

A. I recall the overall amount was \$32,000. It is close, that is the round figure, the amount.

Q. So, you would have recommended in 1946 spending, or incurring obligations up to \$150,000?

A. Definitely not. One was an alternate. First I recommended the additional property adjoining the factory be purchased for future expansion in the amount of 60 cents a square foot, vacant property.

Later on I recommended, that was turned down definitely. [280]

Q. When was this recommendation made, sir?

A. This was in 1946.

Q. In early '46, sir?

(Testimony of Gerald I. Farman.)

A. I can't say, sir. Sorry, I don't recall it. Later on, the same year, I recommended the purchase of the Philco Building in the amount of \$118,000. At that time we had a substantial equity in the building that we were in, and the building is a very saleable building.

As a matter of fact, the equity at that time was far, was quite a bit more than we paid for the building. My proposal was that we would sell that building and apply the amount of money we received from the building on the Philco Building.

Q. And what was the——

A. The Philco Building, I had talked to the Central Manufacturing District, and they agreed to finance the Philco Building for us on a 10 or 15 year plan, either one we choose.

Q. And what was the extent of the liability that would be incurred?

A. About \$75,000, in round figures.

Q. About \$75,000?           A. About \$75,000.

Q. In 1946?

A. In 1946. Had we had our dividends, instead of [281] paying dividends, taken the \$42,000 that would have brought that from \$75,000 down \$42,000.

Q. Now, referring to page 63 of Exhibit K, at the bottom of the page, this relates to the minutes of the meeting of December 15, 1950, we see that there is a report or consideration at least, being given to the purchase of a building in Chicago whereby the net result of the transaction would result in a liability of \$155,000.

(Testimony of Gerald I. Farman.)

Do you see that there, Mr. Farman?

A. I have read part of it. I don't want to take too much time.

Q. Is that correct, sir?           A. Yes.

Mr. Hall: Mr. Farman, you may read all of it. We have the time.

The Witness: I just read the first part of it, and I don't even——

Mr. Hall: Might as well read it all.

The Court: You may take all the time you need, Mr. Farman.

The Witness: Thank you.

Mr. Hall: You may read whatever you want, and take as much time as you want, Mr. Farman.

The Court: It is the material which has been pointed out to the witness, the same as what appears beginning at [282] page 6 of Exhibit 5.

Mr. Hall: That is right, your Honor.

Mr. Gardner: Yes, your Honor.

Mr. Hall: I apologize, your Honor, in making the exhibit we didn't number the same as the pages in the book.

The Witness: All right, I have read enough of it, I believe.

Q. (By Mr. Gardner): All right, sir. Referring specifically to the wording in the minutes relating to the liability of \$155,000 shown at the top of page 64, Exhibit K, it states:

“It was the opinion of the chairman that the company would be unwise to incur a debt in such proportions.”

(Testimony of Gerald I. Farman.)

Were you the chairman then, sir?

A. I was.

Q. And it was your opinion at that time it would be unwise to incur a debt?

A. That is right.

Q. Like that?           A. That is right.

Q. Now, in 1946, you didn't think it was unwise to incur such a debt, did you, sir?

A. No. We had the money in 1946.

Q. Yet, I believe you testified that it was your [283] opinion that the company would go in the red in 1947, and that you knew this in 1946?

A. I didn't say I knew it. I said that I predicted it.

Q. You predicted it, and in spite of this prediction, you were still willing to incur a liability of \$118,000 at that time?

A. Had all things been equal, and Mr. Smith cooperated with the executive committee, none of this would have occurred. Mr. Smith could well have been part of the company today, and could well have been the president of the company. We wouldn't had had losses and wouldn't have had this tax matter, or anything else.

Q. Would you state, sir, how that affects your change in judgment?

A. Well, when I call it simple arithmetic, Mr. Gardner, in business, we paid out to the U. S. National Bank, or Union Bank and Trust—pardon me—the sum of \$15,000. We had a large advertising

(Testimony of Gerald I. Farman.)

debt. This was in 1948. I am starting now in January 15, 1948.

We had a large advertising debt. We have very little working capital, a very low working capital. We were faced with a \$5,000 debt to pay to Mr. Smith. That amount of money had to come from earnings, and it had to come prior to, or be available in the first part of January [284] or the first part of 1951. I do scratch that January 1 part of 1951.

It was my duty and my business to accumulate \$45,000 to pay off this large indebtedness, and certainly, it would have been, I could be very well criticized for misjudgment and mismanagement had I recommended an expenditure of any large amount during that period, or at this time of this meeting.

Q. I see, sir. Now, I believe you have testified that in 1945, when you first came to the company, that you had been alarmed by some of the activities of the prior supervisor, Mr. Colyear, and in part at least, some of your alarm as to the future was a result of certain studies you had made or were making.

Did you make those studies in '45, about, sir?

A. I am afraid I couldn't follow the question, Mr. Gardner. Would you restate it, please. I am sorry, I didn't follow it.

Q. I understood you made certain studies of the corporate business.

A. In 1945 now you are talking about?

Q. Well, I may be in error, but that is what I

(Testimony of Gerald I. Farman.)

understood your testimony to be, that sometime in there you did make a study.

A. That is correct. [285]

Q. Of the business, was that in 1945, sir?

A. I made several studies. I made a study of the business in 1945, in the latter part of 1945.

Q. I see.

A. During 1946, during 1947.

Q. Now, going back to 1939, that was the year just preceding the loss year, wasn't it, sir?

A. Yes.

Q. And at that time, you were rather concerned because emphasis was being placed on—what was that, Double X?

A. Yes.

Q. Now, what is Double X, sir?

A. Double X is a varnish remover.

Q. A varnish remover. Now, what was the reason that you were alarmed about that?

A. Double X is a very high profit item, and was carrying a large percentage of the load, meaning the cost of operations, and selling for the company. It was a high volume item.

Q. But as I understood your testimony, you were afraid that that item would be outmoded because of sanders; is that correct?

A. I said that the sale had decreased materially, and one of the reasons that it had decreased, that the use [286] of electric sanding machines was getting more popular every day.

I also testified that other products were being

(Testimony of Gerald I. Farman.)

introduced to the market, that were easier and more efficient than Double X.

Q. Well now, is a sander easier than any varnish remover, sir?

A. I am afraid that it is a matter of conjecture. I personally wouldn't want to use a sander. It is a very hard thing to do.

Q. I see. Well now, sir, I see in some of these minutes, referring to Exhibit K, which at this time I would like to offer, Exhibit K, in evidence. [287]

\* \* \*

(The document heretofore marked for identification as Respondent's Exhibit K was received in evidence.)

\* \* \*

Q. (By Mr. Gardner): Mr. Farman, referring to Exhibit J, again, page 298, under date of February 26, 1947, would you examine that page and state whether or not you were present at a board of directors' meeting on that date, sir?

A. I remember the meeting and I was present.

Q. Do you remember the discussion regarding Celloglaze?

A. I remember investigating the product. In fact, [289] I went to Minneapolis where Celloglaze was made, and talked to the owners of it, that were manufacturing the product there, in Minneapolis.

Q. Do you know whether or not Celloglaze is presently on the market, sir?

(Testimony of Gerald I. Farman.)

A. I do not know. It was, for many years after that date, but I can't tell you as to date.

Q. Well, after you took over in 1948, did you make any effort to get Celloglaze?

A. I didn't have any money to do anything for two or three years.

Q. In other words, you did not make any effort to get Celloglaze?

A. No, sir.

Q. Did you at any time subsequent make any effort to get Celloglaze?

A. I often thought of it, but I didn't have any money to do anything, and the most necessary thing, is the thing I repeat, that we get enough money to expand our facility so that we can manufacture more products.

The Court: Do all of your operations consist of manufacturing, or do some of them consist merely of packaging raw materials that you buy?

The Witness: Your Honor, I think manufacturing is a misnomer. I think it should be formulation. We don't [290] manufacture raw products. We buy raw products from suppliers who formulate them, and formulation in the form of mixing; then we package them and sell them.

I personally do not believe the word manufacture is correct. I think it should be formulation of products; packaging is the important function.

Q. (By Mr. Gardner): Referring to Exhibit K, page 5 thereof, the meeting of May 30, 1947, would you review that and refresh your recollection as to



(Testimony of Gerald I. Farman.)

whether or not you were present at that meeting, sir?

A. Are you going to refer to all of the minutes? Do you want me to read them?

Q. No. I just asked you if you were present?

A. I was present.

Q. Now, referring to page 7 of Exhibit K, the continuation of the minutes of the meeting of the board of directors of Schalk Chemical Company for May 30, 1948, at about the middle of the page there is a statement which reads as follows:

“Director G. I. Farman thereupon stated that he would like to have a statement of the costs on each of the individual products manufactured by the Schalk Chemical Company, showing the profit on each.

“Thereupon, a discussion took place as to the [291] feasibility of determining cost accounting in connection with the request for a statement of costs. Mr. Farman stated that the records which he had made up for the year 1945 showed an operating overhead of 14.2 percent, sales expense of 13.88 per cent, and administrative expense of 12.07 per cent, and advertising expense of 22 percent; making a total of 62.15 percent as the cost of operating during the year 1945.”

Do you recall making that statement, Mr. Farman?

A. I don't recall it, no.

Q. Do you recall making that analysis?

(Testimony of Gerald I. Farman.)

A. I don't recall it. I made many analyses and this specific one I could not say I recall it definitely.

Q. Do you recall whether or not at a subsequent date the figure of 62.15 percent as shown on page 7 of Exhibit K was corrected to read 55 percent?

A. This——

Mr. Hall: By Mr.——

The Witness: This is a statement by Mr. Rausch. I don't recall the statement, no more than I recall——

The Court: What are you pointing at?

The Witness: Mr. Rausch is the——

Mr. Gardner: We are pointing at page 12 of Exhibit K, sir. [292]

Q. (By Mr. Gardner): I would like to refer you to page 10 of Exhibit K, sir, relating to a meeting of the board of directors for June 19, 1948; would you look at that and state whether you were present at that time, sir?

A. Yes, I remember.

Q. Do you remember whether or not this was what took place as shown by page 10 of Exhibit K:

“Thereupon, a discussion ensued with reference to the figures which Director G. I. Farman had given at the last meeting with reference to the overhead and cost of production during the year '45. The figures which Director Farman contended represented the overhead for that year was 67.78 percent. Director Rausch stated that there was an error in these figures, and that the overhead was approximately 52 percent, and that in his opinion the figure

(Testimony of Gerald I. Farman.)

used by Mr. Farman included a double charge for factory labor.”

Do you recall that, sir?

A. I don't recall it. It is a simple matter of checking.

Q. That was one of the things you were complaining though, was the increase?

A. The big thing that I was complaining about, that you haven't brought out, is my complaint of spending the large amount of moneys in 1945, 1946, and 1947 on [293] advertising. Those were major factors. And if they are not in the minutes, the minutes are not complete. I again say that I am not saying they are incorrect. I say they are incomplete.

Q. I would like to have you examine page 12 of Exhibit K, minutes of the meeting of July 9, 1947, and ask whether or not you were present at that meeting, sir?

A. I was present.

Mr. Hall: Mr. Gardner, I request that the witness be allowed to read that whole set of minutes, and the next succeeding minutes. That is, that he be allowed to read from page 12 through 17.

Mr. Gardner: You mean aloud?

Mr. Hall: No, no, to himself.

The Witness: How far did you want me to read?

I believe I have gone as far as necessary.

Q. (By Mr. Gardner): You have been examining the——

A. I have been examining——

(Testimony of Gerald I. Farman.)

Q. —the pages in Exhibit K, sir?

A. The—well, the pages that were suggested from here to here.

Q. 12, 13 and 14 of Exhibit K?

A. I believe that is right.

Q. All right, sir. Do you recall making a recommendation [294] that a Milldew proover be sold by the company?

A. I recall making a very definite recommendation that a cleaner with a germicide added be introduced, be produced and introduced to the market by the company. The word “Milldew Proover” were words that were being batted around during the conversation. I recall very well stating that the only place that a milldew proover is of any—has any volume of sale is in the south and down in Florida.

Therefore, the important thing was to get a germicide in the product to kill fungus, germs, etc.

Q. Do you now have such a product, sir?

A. We do not, no, not as such.

Q. Do you recall the president—that is Mr. Smith—stating to you that one of the brokers for the Schalk Chemical Company had reported that the grocery trade would probably not be interested in such a product?

A. Well, Mr. Gardner, since this recommendation there must be at least ten very excellent products on the market that have a volume considerably over \$100,000, each item over \$100,000 a year.

Q. I am sorry, Mr. Farman, apparently I didn't make my question clear.

(Testimony of Gerald I. Farman.)

What I asked was whether or not the president, Mr. Bob Smith, Horace O. Smith, Jr., didn't state to you that he had a report from one of the brokers of Schalk [295] Chemical Company regarding the advisability of preparing and manufacturing that product; did he tell you that, do you remember?

A. I don't recall it. I read it in the minutes, and I assume it is correct.

Q. In other words, when he received an idea from you, he took steps to determine whether or not that idea might work, didn't he?

A. In this instance he did, yes, this one instance.

Q. This is the only instance?

A. That is the only instance so far that you have brought up.

Q. But in order to save time, Mr. Farman, it is reflected in the minutes that the president did investigate the possibilities of a market for a product suggested by yourself, or one of the other members?

A. This one product you are talking about?

Q. No. Any product as reflected by the minutes of the company.

A. I didn't write them.

Q. Would you say that would be correct?

A. I didn't write the minutes.

Q. All right, sir. Referring to page 10, sir, of Exhibit K, minutes for January 19, 1947, again—

A. Are these some that I have identified before? [296]

Q. I am not sure, sir; would you look it over

(Testimony of Gerald I. Farman.)

and see whether or not you were present at that time?

A. Oh, yes, I read that.

Q. You have read that?

A. Right. I was present.

Q. Going to page 10 thereof, second paragraph from the bottom:

“The president read several reports on the subject of fungicide, and stated that he would prefer to have reports from an agency recording sales in the southern territory as in his opinion this was a region product, and it seemed that the southern states were the place where it would most likely be sold. No action was taken by the board with reference to the fungicide.

“Thereupon, discussion ensued with reference to the waterproofing for concrete and cement. The president stated that so far he had not had time to receive reports from the various individuals that he had contacted, and requested this matter go over for two weeks.

“Director Farman conceded to the delay.”

Do you recall that, Mr. Farman?

A. Yes, sir.

Q. In other words, your president was taking steps to determine whether or not these products were marketable wasn't he? [297]

A. Yes. I imagine he was in this particular case, that one instant.

Q. Now, that is two instances.

A. All right; that is two instances.

(Testimony of Gerald I. Farman.)

Q. All right, sir.

Referring to page 297 of Exhibit J, the minutes for the meeting held the 19th day of February 1947; do you want to examine that, sir, to see whether or not you were there?

A. Sure do. Yes, I was there.

Q. Now, referring to page 297 of Exhibit J, regarding Celloglaze:

“Thereupon, Director G. I. Farman stated that on his recent trip to Chicago, he went to Minneapolis and investigated a product known as Celloglaze, which is a liquid solution used as a furniture polish and as a polish for automobiles. Mr. Farman discussed the product in detail, and stated that he had procured a tentative contract with the owner of said product and the contract was presented to the board for its consideration.

“The president stated that he had made some investigation of this product, and most of the advice he had gotten was against the Schalk Chemical Company taking over Celloglaze.

“The president further stated that he desired to [298] make a further investigation of this matter, and it was thereupon suggested that the president communicate immediately with the Chicago office and have an investigation made by the office at Chicago, and send an immediate report back to the president as to the result of the investigation.

“Thereupon, the directors requested G. I. Farman to contact the owner of Celloglaze and request the

(Testimony of Gerald I. Farman.)

owner to extend for one week the option which he had heretofore taken concerning Celloglaze.”

Now, do you recall that, Mr. Farman?

A. I do.

Q. This is another instance in which the president is taking steps to investigate the advisability of marketing this product, isn't it?

A. It is not.

Q. All right, sir.

A. This is another case of prejudice in any product that we offered. Mrs. Farman or any members of the family offered, there was prejudice entered into and it is evidenced by the fact that he did not accept these products. Had he accepted Celloglaze, he had accepted a mighty good product.

Q. Do you have it today, sir?

A. No, I don't have it. I manage to solve the market. [299]

Q. Did you ever accept it?

A. I would have accepted it. I didn't have any money, I told you, prior to the last couple of years, and I haven't had any money to do very much with there, but we have introduced nine new products since that time.

Q. None of which is not Celloglaze?

A. None of which is not Celloglaze. I know Celloglaze was an excellent product.

The Court: You mean none of which is Celloglaze?

The Witness: None of which is Celloglaze.

Q. (By Mr. Gardner): Just a couple of more questions.



(Testimony of Gerald I. Farman.)

I believe you testified that in 1946 you made a suggestion to the board of directors that they develop a paint varnish, or varnish remover of some sort; is that correct?

A. Paint and varnish remover is the word.

Q. What is it?

A. Paint and varnish remover.

Q. Paint and varnish remover; is that correct?

A. That is correct.

Q. Now, I believe you testified also that you did develop a paint and varnish remover in 1956; do you recall that, sir?

A. Yes. Did I say 1955 or '56? [300]

Q. Well, I have in my notes '56.

A. Well, it could be either one, sir.

Q. '55 or '56. Now, Mr. Althouse, I guess he is manager now, isn't he, for Schalk?

A. He is my assistant.

Q. He is your assistant?

A. Yes.

Q. Testified that it took approximately one year to get a product on to the market. Do you recall that, sir?

A. From the time of its—we start with the idea until it is on the market, yes, sir, I would call it, it is a fact.

Q. Could you tell me, sir, why it took from January of 1948 to sometime in 1955 or 1956 to get this valuable paint and varnish remover on the market?

A. I can very well, sir.

(Testimony of Gerald I. Farman.)

Q. Fine.

A. We didn't have any money as stated before. We had to save enough money to pay the \$45,000 to Mr. Smith. We had to pay off a \$15,000 indebtedness to the bank, and had to pay off an indebtedness, an X number of dollars that I don't recall, to the Central Manufacturing District on our contract for the property or land, or building in Chicago.

Therefore, we would not spend any money, only, [301] any unnecessary money for new products during the period of 1948, 1949, and 1950. We may have produced a product during that time but we were not spending money. We didn't have the money to spend in the meantime.

I believe Mr. Althouse testified, and I wish to testify, that there are at least 50 paint and varnish removers on the market, and it was only a "me too" products because our customers demanded that we put it in. We did that late in the game with all the competition that we had to face with it.

Q. There is just one other point, and then we are finished, Mr. Farman.

I believe you testified to the effect, or your assistant, Mr. Althouse, I don't recall which, testified to the effect that as of today you have 17 products; is that correct, sir?

A. There are 16 shown in our catalogue. We have 17 products.

Q. You have 17?

A. I believe that is correct.

Q. And your latest figures as to the profit de-

(Testimony of Gerald I. Farman.)

rived from your individual products indicate that 53 percent of your profit now comes from the new products; is that correct, sir?

A. This is Mr. Althouse's testimony, if I may correct [302] you and if that is his testimony, it is correct.

Q. And 47 percent then of your profit now comes from the same old tried and true products that you have always had?

A. I imagine that is correct. I would have to do some checking, but if that is Mr. Althouse's testimony, it is correct.

Mr. Gardner: No further questions.

#### Redirect Examination

By Mr. Hall:

Q. Mr. Farman, with regard to the question you last answered, which concerned Mr. Althouse's testimony, that the 53 percent of the gross sales in 1957 were the result or were attributable to the nine new products, and Mr. Gardner asked you if the 47 percent, the corresponding percentage was attributable to the eight old products, if I may say it that way, referring to your answer, do you put out any new products under what is called a private label?

A. We private label some bulk products, Mr. Hall. One of them is called Citrox, very high profit product, of secret formula that we put out only in bulk form. We put out several bulk products.

Q. And the total gross sales include those bulk products?

(Testimony of Gerald I. Farman.)

A. Yes, they do. [303]

Q. That would diminish the 47 percent that Mr. Gardner was referring to?

A. It would diminish it considerably.

Q. Now, at the beginning of Mr. Gardner's cross-examination, he asked you concerning your appointment, or the request made by Mrs. Farman and Mrs. Baker and Mrs. Marlow, that you assist them in regard to management of Schalk Chemical Company. Do you recall that line of questioning?

A. I recall the question, but I don't know as I—

Q. In what year did they request that you leave whatever job you had, and come to work for Schalk?

A. 1945.

Q. Did they request that at any time prior to that?

A. Well, there were many requests, not many, several requests made prior to 1940 by Mrs. Farman and the two girls that they would like to have me in Schalk, but in 1945 it was, it had reached a point where they requested very definite assistance.

Q. Now, Mr. Gardner questioned you at length on your prior occupations.

The Clerk: Exhibit 28 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 28 for identification.)

Q. (By Mr. Hall): Mr. Farman, do you know, or did you ever know a Captain C. L. Hahn? Captain, Corps of Engineers.

(Testimony of Gerald I. Farman.)

A. I did.

Q. Did you work for Captain Hahn?

A. I did.

Q. When was that?

A. During period of 19—I can't point it right down. It was probably during a part of '35 and '36, maybe part of '37. It is very hard to remember the exact dates.

Q. And was he your supervisor at that time?

A. He was at the time that I worked for him. He was my immediate superior, yes.

Q. Do you know a Captain Hahn or did you know Captain Hahn's signature at that time?

A. I did; yes, sir.

Q. Would you be able to recognize it today?

A. I would.

Q. I show you Plaintiff's Exhibit 28 for identification, and ask you if that document bears Captain Hahn's signature?      A. It does.

Q. Mr. Farman, do you know what this document is, what is it called?

A. This is called an efficiency record, developed I believe originally by the Navy and used by the Corps of [305] Engineers in the War Department as to the efficiency of soldiers and officers and employees.

Mr. Gardner: No objection.

Mr. Hall: I offer this in evidence, your Honor, Petitioner's Exhibit 28.

The Court: Admitted.

(Testimony of Gerald I. Farman.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 28 was received in evidence.)

Q. (By Mr. Hall): Now, Mr. Farman, Petitioner's Exhibit 28 is dated November 15, 1937, and it shows a classification for G. I. Farman at that time of assistant supervisor, operations, and a base rate of pay of \$450 per month. Does that, does the exhibit reflect the true state of facts to the best of your recollection?

A. To the best of my recollection it is correct. It is signed by Captain Hahn and is an efficiency record.

Q. Now, the classification there is assistant supervisor, operations. Was your position with the WPA changed after that date, November 15, 1937?

A. I was advanced from assistant supervisor, operations, to deputy director of operations and later to director of operations.

Q. Now, in testifying concerning a \$550 salary from [306] WPA, which position were you referring to?

A. Well, I was referring, and I believe that if I understood it correctly, all of our conversation was a director of operations, and that was the \$550 salary I was referring to, as director of operations at WPA.

Q. And I believe you mentioned the figure \$750.

A. I said——

Q. At one time——

(Testimony of Gerald I. Farman.)

A. I said that it was possible, and very possible, that it was that, I received a salary higher than \$550. I don't believe I stated what I based it on, but if I may state that, I would like to have it in the record, if it is of any consequence.

Q. You base the \$750 on?           A. Yes.

Q. Go ahead.

A. I recall a meeting between the director of the Works, of the—western director of the Works Progress Administration, Mr. Langley and Col. Harrington, the chief engineer of the Works Progress Administration, in Mr. Conley's office, and they were requesting that I take over the position of—may I have that card just a minute. I don't know what they called it.

They had asked me to take over the duties and position and duties of district director of Southern [307] California, and at that time Col. Langley or Mr. Langley, stated, "Well, Farman, you are the highest paid civilian on the West Coast in the Works Progress Administration," and that my salary would be about what I was receiving at that time, and he said—I said, "Well, what is that," not thinking, and he said, "\$750."

Now, I don't, I can't tell you that I received \$750. I tried to make that clear the other day.

Q. Thank you, Mr. Farman.

Did you, at any time with the WPA, work for a Col. Dillon?           A. Yes, I did.

Q. In what position were you when you worked with, or for Col. Dillon?

(Testimony of Gerald I. Farman.)

A. Col. Dillon was director of employment when I first went in in 1935; when I was first transferred from Washington I was assigned to him the first thing.

Q. How long did you work with Col. Dillon??

A. Well, actually, I can't recall in the personnel department how long I worked. It was rather a short period of time, and I was then transferred because of an opening in operations that they needed help, and—however, Col. Dillon was assistant or deputy director, so I was definitely under him for about three years, maybe a little more than three years. [308]

Mr. Hall: Your Honor, I would like to put a witness on out of turn for the convenience of the witness, and defer Mr. Farman's redirect examination until after this witness.

Mr. Gardner: No objection, your Honor.

The Court: You may do so.

Mr. Hall: Call Colonel Dillon.

### COLONEL LEE S. DILLON

a witness called by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Hall:

Q. Sir, are you Colonel Lee S. Dillon, Corps of Engineers, U. S. Army, retired?           A. I am.



(Testimony of Colonel Lee S. Dillon.)

The Clerk: Would you state your address, please, Colonel Dillon?

The Witness: 3055 D Street, San Bernardino.

The Clerk: Mark Exhibit 30 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 30 for identification.)

Q. (By Mr. Hall): Colonel Dillon, I hand you a document that has been marked Petitioners' Exhibit No. 30 for identification. Do you recognize that document? [316]

A. I do.

Q. Will you briefly describe what it is?

A. It is a letter giving my opinion of the character and ability of Jim Farman.

Q. That letter is dated August 4, 1957?

A. That is right.

Q. And it is signed by you, sir, is that correct?

A. That is right.

Mr. Hall: I offer this as Plaintiff's Exhibit No. 30.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Exhibit No. 30.

(The document heretofore marked Petitioners' Exhibit No. 30 for identification was received in evidence.)

Q. (By Mr. Hall): Colonel Dillon, Petitioners' Exhibit No. 30 states that in 1940 you offered Mr. Farman a position, and according to the letter you got special authority from Washington to offer him

(Testimony of Colonel Lee S. Dillon.)

the position at what was then an "unusually large salary for a government engineer," and that ends the quote. What was the salary which you offered to Mr. Farman in 1940?

A. I had the authority to pay from \$12,000.00 to \$15,000.00. [317]

#### Cross-Examination

By Mr. Gardner:

Q. Colonel Dillon, what was the occasion for writing this letter, Petitioners' Exhibit No. 30?

A. As I remember it, I got a request from Mr. Guthrie for a letter as to my opinion of Mr. Farman.

Q. Did he state why he wanted your opinion, sir?

A. I don't remember whether he did or not.

Q. Do you remember what salary you employed Mr. Farman at in 1940?

A. I never employed him in 1940; he didn't accept the job. I had the authority to pay him from \$12,000.00 to \$15,000.00.

Q. He didn't accept the job?

A. He did not.

Mr. Gardner: No further questions.

#### Redirect Examination

By Mr. Hall:

Q. Colonel Dillon, did you know Mr. Guthrie prior to his contacting you?

A. I had met him, yes.

(Testimony of Colonel Lee S. Dillon.)

Q. Who was Mr. Guthrie?

A. He was a lawyer, I believe, who handled a lot of Mr. Farman's business. [318]

\* \* \*

Mr. Hall: Call Mr. Farman.

### GERALD I. FARMAN

called as a witness for and on behalf of the Petitioners, having been previously duly sworn, resumed the stand and testified further as follows:

#### Redirect Examination

By Mr. Hall:

Q. Mr. Farman, what is your age?

A. I will be 65 next month.

Q. Now, during the years 1935 to 1939 what was the highest position you held with the WPA when it was under the Corps of Engineers?

A. Director of Operations.

Q. And while you were in that position, did the office which you controlled make an accomplishment report of the work of that division?

A. It did.

Q. That was the Operations Division, is that correct?      A. Correct.

The Clerk: Exhibit No. 31 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 31 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you a book that has been marked Petitioners' Exhibit

(Testimony of Gerald I. Farman.)

No. 31 for identification, and ask you if that is the Accomplishment Report, or Report of Accomplishments of the Operations Division, Work Progress Administration, Southern California, which you referred to?           A. It is.

Q. Was that prepared under your supervision?

A. It was.

Q. And at the time of this report, as Director of Operations, who was your immediate supervisor?

A. Colonel Donald H. Connelly.

Mr. Hall: I offer this as Petitioners' Exhibit No. 31.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Petitioners' Exhibit No. 31.

(The document heretofore marked Petitioners' Exhibit No. 31 for identification was received in evidence.)

Q. (By Mr. Hall): Mr. Farman, on cross examination it was suggested, on Mr. Gardner's examination, that at some time in your background you went broke. Was there ever any occasion on which on any business enterprise that you had that you went broke?

A. I never went broke.

Q. On cross examination you testified as to an [320] employment contract which Mr. Colyear demanded from Schalk Chemical Company in 1931 or 1932, I don't recall which year; when that contract was objected to, what did Mr. Colyear do?

(Testimony of Gerald I. Farman.)

A. Well, he got extremely mad, and then from that date on he refused to cooperate with any of the family.

Q. Did he take any other action at that time?

A. He sued the company for salary.

Q. Mr. Farman, Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk, at Page 147, contains this following statement made by Henry O. Wackerbarth, the Secretary of the corporation, "On the 13th day of May, 1932, as Secretary of the Schalk Chemical Company, I was served with a copy of the summons and complaint in an action now pending in the Superior Court of the State of California in and for the County of Los Angeles, and entitled Curtis C. Colyear, Plaintiff, versus Schalk Chemical Company, a corporation, Defendant, No. 340461; that said action was brought by the plaintiff for the purpose of recovering the reasonable value of his services rendered to the corporation as general manager."

Is that the suit that you had reference to?

A. That is the suit I had reference to.

Q. And was that suit later dismissed?

A. It was later dismissed.

Mr. Hall: For the record I state that the resolution [321] and agreement of Mr. Colyear is set forth at Pages 157 to 158 of Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk Chemical Company.

Your Honor, I think I made a misstatement before in reference to this exhibit. It is Respondent's

(Testimony of Gerald I. Farman.)

Exhibit J; it is on the wrong line here and I will ask the Clerk to correct it.

Q. (By Mr. Hall): Now, Mr. Farman, on cross-examination you testified I believe that you have followed the practice of endorsing to Mrs. Farman your salary checks from Schalk Chemical Company. Now, Mr. Farman, did you mean that you received no personal benefit from such funds?

A. Oh, no, I didn't mean it that way.

Q. What does Mrs. Farman use those funds for?

A. For the maintenance of her home and living expenses, from which I derive a benefit; I live there and I derive a benefit.

Q. Well, did you actually endorse the checks that you received?

A. I doubt if I endorsed very many of them; I hand the check to her and she deposits it in her account.

Q. Now, did you and Mrs. Farman enter into a property settlement agreement prior to your marriage? A. We did. [322]

Q. What was the general nature of that agreement?

A. Briefly, what was hers was her own, and what I had was my own, prior to our marriage.

Q. Now, regarding Mr. Fulmer, the former manager of the Chicago plant, or the Eastern Division of Schalk Chemical Company, how old was Mr. Fulmer in 1948?

A. Well, he told me he was past 65.

(Testimony of Gerald I. Farman.)

Q. Did he object to coming to California?

A. No, he welcomed it, to my best knowledge and belief.

Q. Now, on cross-examination, Mr. Farman, you testified that you thought Mr. Lieben was appointed manager of Schalk Chemical Company in place of Mr. Williams in 1931 or 1932. Mr. Farman, I refer you to Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk, Page 255, in which there is a resolution as follows: "Resolved that H. C. Lieben be appointed the general manager of Schalk Chemical Company and be granted power and authority to manage and operate said business, subject, however, to the control, ratification and approval of the Board of Directors of said company."

Mr. Farman, to your knowledge, was Mr. Lieben appointed manager of Schalk Chemical Company prior to that date?

A. Not to my knowledge, no, definitely not.

Mr. Hall: I didn't mention the date, your Honor, that is [323] the minutes of April 26, 1944.

Q. (By Mr. Hall): Well, did he act as manager prior to that date?

A. That was my understanding, yes, that he was the manager of this operation in Los Angeles, more of an understanding.

Q. Mr. Farman, on cross-examination you were asked some questions concerning the minutes of a meeting of the Board of Directors of Schalk Chemical Company on December 11, 1946, which are set

(Testimony of Gerald I. Farman.)

forth in Respondent's Exhibit J at Pages 280 to 282, and I call your attention to the bottom of Page 281, and the sentence which reads, "Director G. I. Farman called the attention of the Board to the fact that he had contracted an indebtedness of \$16,000.00 for an automatic filling machine and an automatic crack filler," that is the end of the sentence.

Is that a correct statement?           A. It is not.

Q. Will you tell us what is incorrect about it?

A. The amount of money contracted, \$16,000.00 is very incorrect.

Q. Did you ever contract a \$16,000.00 indebtedness for Schalk Chemical Company for machinery?

A. Not during that period.

Q. And during that period, what period do you mean?           A. Of 1945, '46 or '47. [324]

Q. Is the description of the machines accurate?

A. On that automatic filling machine and the automatic crack filler, I imagine it means one machine. It is not properly worded but it is as accurate as an apprentice would get it, probably.

Q. Well, in 1945 and 1946 did you have anything to do with acquiring one or more machines?

A. I recommended the purchase of two or more machines, three machines, in fact, during those two years.

Q. Well, the first two, what machines were they?

A. An automatic, semi-automatic crack filling machine, and a semi-automatic packaging machine



(Testimony of Gerald I. Farman.)

for all sizes, all size packages up to one pound, starting with a three ounce size.

Q. What was the purchase price of those machines, if you recall, roughly?

A. Well, the purchase price of the one machine was \$1500.00, the other machine I believe was about \$1200.00. Those are the two main machines.

Q. Was one of those machines for use in Los Angeles?

A. One was for use here and is being used here, the other one was for use in Chicago.

Q. Now, on Page 282 of the same minutes, it states, "He," referring to Director G. I. Farman, "also suggested that it would be advisable to purchase an automatic filling machine for half-pound packages of Savabrush and that such a machine [325] would cost approximately \$8000.00 installed."

Was that machine purchased? A. It was.

Q. When was it purchased approximately?

A. In 1946, I can't give you the exact date.

Q. Did you purchase that machine?

A. I did not, I recommended the purchase of that machine.

Q. Was that machine ever installed, to your knowledge?

A. That machine was not installed until 1948 after I went in as president.

Q. At that time was it installed and used?

A. It was.

(Testimony of Gerald I. Farman.)

The Court: Is that the machine that has previously been referred to as the one standing around in the warehouse for a year?

The Witness: Yes, sir.

Q. (By Mr. Hall): Mr. Farman, I refer you to the general ledger of Schalk Chemical Company for the year 1947, Account No. 03-C, and I call your attention to an entry on May 15, 1947, showing a debit of \$8,058.00. Is that the price paid for the machine which you recommended that somebody else purchased, the fully automatic machine?

A. It is. [326]

Q. And that is the machine that was not installed until you took over, is that correct?

A. That is correct.

Q. On cross-examination, Mr. Farman, you were asked some questions regarding proposals in 1946 by you and Mrs. Farman to expand the plant and facilities of the company in Chicago.

Mr. Farman, I refer you to the minutes of the Board of Directors of Schalk Chemical Company dated July 24, 1946, which are set forth in Respondent's Exhibit J, Volume 4 of the Minute Books of Schalk Chemical Company at Pages 276 to 279, and the statement therein, "Thereupon Director Hazel I. Farman stated that she desired to present to the Board for consideration the matter of securing new quarters in Chicago, Illinois, or in that vicinity, for the reason that the present quarters would be inadequate in the event the Schalk Chem-

(Testimony of Gerald I. Farman.)

ical Company took on additional merchandise for sale. The matter was discussed by the Board for some time but no decision was arrived at."

I also refer you to the minutes of the Board of Directors of Schalk Chemical Company dated December 16, 1946, which appear in the same exhibit at Pages 280 to 282, and specifically Page 282 where it is stated, "The question of expansion of the plant facilities at Chicago and the matter of additional bonuses to the officers were also considered by the [327] meeting."

Now, Mr. Farman, was it in that period that the proposals to expand the facilities at the Schalk Chicago plant were made by you and Mrs. Farman?

A. It was.

Q. Now, you testified that it was possible at that time to purchase the Phileo Building which was near the plant of Schalk in Chicago. As I recall it, your testimony was that that would have cost Schalk \$118,000.00, is that correct?

A. That is correct.

Q. How much equity in your opinion would Schalk have realized from the sale of its then existing plant in 1946, approximately?

A. \$42,000.00. If you would like me to explain it, I can do it, but \$42,000.00.

Q. No; well, how much would it have cost Schalk a year to finance the balance of the purchase price of the building, to pay the balance of the purchase price?

(Testimony of Gerald I. Farman.)

A. I worked it out with the Central Manufacturing District, it was \$6000.00 a year plus interest.

Q. And you had an arrangement for the financing at that time? A. I did.

Q. Who was that with?

A. Central Manufacturing District of Chicago.

Q. Mr. Farman, on cross-examination you testified, I believe, that Mr. Smith liked to work in the factory, mixing and packaging Schalk products, was that your testimony?

A. I believe it was.

Q. Of your own knowledge when if ever did this occur? A. Well, it occurred in 1946.

Q. Is that the only time you recall?

A. That is the time I recall.

Q. At that time did his working in the factory have anything to do with a shortage of employees?

A. Not at all.

Q. Mr. Farman, according to the books and records of Schalk Chemical Company, was your salary in 1945 and 1946 more or less than the salary paid to Mr. Smith? A. It was less.

Q. What was the salary paid to Mr. Smith?

A. \$500.00 a month, as I recall it.

Q. In 1945 and 1946, is that correct?

A. Yes; that is right.

Q. During the same period was Mr. Fulmer's salary more or less than Mr. Smith's?

A. It was more than Mr. Smith's.

Q. Do you know how much it was?

(Testimony of Gerald I. Farman.)

A. As I recall it from memory it was \$750.00 a month.

Q. Now, on cross-examination, Mr. Farman, you made [329] several statements concerning the operations and condition of Schalk Chemical Company prior to the year 1945. What was the source of your information in that regard?

A. Prior to 1945, as the husband of Mrs. Farman.

Q. Well, was this the result of conversations with Mrs. Farman?

A. Conversations, financial reports and other records that she would bring home or send to me wherever I was.

Q. Mr. Farman, I refer you to Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk Chemical Company, at Page 221 and the memorandum which is inserted at that page which is a memorandum from H. C. Lieben to C. C. Colyear, President, dated January 25, 1941.

On Page 2 of that memorandum it states, "While our other specialty items have either held their own or enjoyed an increase, Double X Floor Cleaner has been declining rapidly since 1937. This has been due primarily to increased competition of lower priced items, use of new floor finishes and increased usage of sanding machines."

Now, Mr. Farman, is that expressive of the downward trend of the mainstay product, Double X, prior to the war, that you testified to last Thursday?

A. It is a very good explanation.

(Testimony of Gerald I. Farman.)

Q. In answer to a question by the Court, Mr. Farman, you stated that Schalk does not manufacture its products. I [330] would like you to explain a little further, what exactly Schalk does in putting out its products.

A. We purchase raw materials from manufacturers, formulate them, sometimes called blend them, formulate them by mixing them and package them, put them in packages of various sizes, if it is liquids it goes in cans, the dry powders go in either fiber cans or packages.

Q. The formulation is in accordance with a formula, is that correct?

A. Yes; it is followed—

Q. Now, on cross-examination you testified that the present management did not put a paint and varnish remover on the market until 1955 or 1956, notwithstanding that in 1946 you and Mrs. Farman recommended the product for the Schalk line.

Now, Mr. Farman, in 1946 how many national competitors were marketing a liquid paint and varnish remover?

A. Two, to my best knowledge and belief.

Q. Who were they?

A. Savagram Company of Boston and Wilson Imperial in New Jersey.

Q. Now, in 1948 and 1949 when you took over management of the company, how many national competitors were marketing a liquid paint and varnish remover?

A. Well, I would be glad to establish a minimum

(Testimony of Gerald I. Farman.)

figure of 20. I have records to substantiate that in my personal file. [331]

Q. Now, in 1948 when Schalk Chemical Company put tile cement on the market, how many competitors were making a similar product, if you know?

A. I would judge not over two or three.

Q. How about patch paste which was put on the market in 1950?

A. I believe, as I recall it, we had three; there were three on the market, but one had failed and pulled off. They were new and not proven.

Q. And tile paste in 1952?

A. There were about four on the market when we put that on the market.

Q. And Liquid Savabrush in 1953?

A. Very highly competitive, probably 20 or 30 of them.

Q. And Liquid Waxoff in 1954?

A. We were a leader, I mean there was one other, the Bruce Asphalt Tile Cleaner that was on the market at that time.

Q. And in 1956 Sure-X, X-It, and Do-X were put on the market by Schalk; what was the competitive position at that time?

A. Very highly competitive.

Q. Is that the paint and varnish remover?

A. Two of those are the paint and varnish removers.

Q. What is Do-X?

A. Do-X is a wall cleaner. [332]

(Testimony of Gerald I. Farman.)

Q. Now, in 1957, S-14 Spackling Compound was put on the market; what was the competition position at that time?

A. S-14 formulated with a polyvinyl is very new. I would say that we maybe have two or three competitors at this time, successful competitors.

Q. Now, Mr. Farman, what is the Schalk merchandiser?

A. That is a sales aid wherein we put representative stock in a retail store of all our items and it is a promotion item.

Q. Would you briefly describe what it is?

A. Well, it is made of cardboard, the stand is, it is seven inches wide, 24 inches long, and 27 inches high, and has shelves and at the top it says, Home Repair Products, and the products are placed on the shelves; if it a self-service merchandiser. It is actually, what it is, we call it a self-service merchandiser.

The Court: Is what you are talking about illustrated on the back page of Exhibit 14?

The Witness: It is, sir.

Q. (By Mr. Hall): When did Schalk first commence using the Schalk merchandiser?

A. It was in the early 50's, I don't recall the exact date.

Q. Prior to that time was there anything similar to [333] that used by Schalk Chemical Company?

A. Printer's Ink, and Sales Management, both published pictures of it and said it was the first thing like it in its field.



(Testimony of Gerald I. Farman.)

Q. Now, Mr. Farman, on cross-examination Mr. Gardner pointed out instances in 1947 as to which the minutes of the company show that new products were suggested to management by you and Mrs. Farman.

Prior to the time that the executive committee was disbanded, how were the proposals for new products handled?

A. They were handled in an executive committee meeting, if I understand your question properly.

Q. Were minutes or memoranda of those meetings kept?      A. Yes.

Q. Who kept them?      A. I did.

Q. When would they be prepared?

A. Well, we will say immediately after the meeting or the same day as the meeting.

The Clerk: Exhibit No. 32 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 32 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioners' Exhibit No. 32 for identification and ask you if those are the minutes or [334] memorandum which you prepared?      A. They are.

Q. Are those, most of them that are in that group in your handwriting?

A. Yes; they are.

Q. I should say all of the longhand memoranda are in your handwriting, is that correct?

A. That is right.

(Testimony of Gerald I. Farman.)

Q. And who was present usually at those meetings?

A. Mrs. Farman, Mr. Smith and myself.

Q. And, for example, there is a meeting on top here, September 27, 1945, 10:00 a.m.; when was the memorandum of the meeting prepared by you?

A. The same day, very definitely.

Q. That was your custom and practice?

A. That is my custom and practice.

Mr. Gardner: May I ask a question on voir dire, your Honor?

The Court: You may.

#### Voir Dire Examination

By Mr. Gardner:

Q. Petitioners' Exhibit No. 32 for identification are minutes of the executive committee meetings?

A. Yes.

Q. Are these the official minutes? [335]

A. I would say official minutes, yes.

Q. What makes them official?

A. It was a full committee meeting of the executive committee, was set up by the board of trustees or board of directors of the corporation.

Q. Were the minutes of the previous meeting read at the subsequent meeting?

A. They were often read, yes, sir.

Q. Were they read every time, sir?

A. I can't swear to it; I would say yes, I definitely would.

(Testimony of Gerald I. Farman.)

Q. Your testimony is these minutes were read at the next meeting? A. Yes; I did.

Q. You read the minutes?

A. I kept a file and read the minutes.

Q. Would they be passed on as correct, sir?

A. They never were passed on; Mr. Smith often got up and walked out.

Q. Who directed you to keep these minutes?

A. Why, I imagine I directed myself to keep them.

Mr. Gardner: I object to the introduction.

Mr. Hall: I haven't offered it yet. [336]

### Redirect Examination

(Continued)

By Mr. Hall:

Q. Mr. Farman, as to what took place at these meetings, do you have any independent recollection apart from these memoranda that you made?

A. No; I haven't.

Mr. Hall: I offer them as Petitioners' Exhibit No. 32.

Mr. Gardner: I object to the introduction of these so-called minutes, your Honor. This is nothing more or less but a self-serving document prepared by the witness later and they have no official capacity whatsoever. It would be the same thing if he went home and wrote a note about the day's occurrence, naturally in the most favorable light to the witness.

Mr. Hall: Your Honor, they are memoranda of what he observed to transpire, and as memoranda

(Testimony of Gerald I. Farman.)

they are admissible. He has no direct recollection on the subject.

The Court: Were these contemporaneously kept?

The Witness: They were kept at every meeting.

The Court: How soon after the meeting did you prepare these?

The Witness: The same day.

The Court: I will admit it.

The Clerk: Petitioners' Exhibit No. 32.

(The document heretofore marked Petitioners' Exhibit No. 32 for identification was received in evidence.) [337]

The Court: What is the reason for the establishment of the executive committee?

The Witness: To try to eliminate the friction that was going on and to get co-operation and expansion of the company.

The Court: So there were difficulties with Mr. Smith prior to the formation of the executive committee?

The Witness: Yes, sir.

The Court: And that was an attempt to furnish a solution to the situation?

The Witness: Yes, sir.

Mr. Hall: Your Honor, I call your attention to Petitioners' Exhibit No. 15 on the question that you asked. This is a letter on the letterhead of Henry O. Wackerbarth. That letter, your Honor, states that in settlement of the controversy then existing there had been an agreement to set up or there was an agreement to set up the executive committee.

(Testimony of Gerald I. Farman.)

Q. (By Mr. Hall): Now, Mr. Farman, was there any general management and sales meeting in 1945 that you attended? A. Yes.

Q. Do you recall where that was held?

A. At the Biltmore Hotel here in Los Angeles.

Q. Approximately what time of the year?

A. It was either November or December, 1945.

Q. And do you recall who was present at that meeting? [338]

A. Well, Mrs. Farman and Mr. Smith, Mr. Fulmer, Mr. Lieben, Mr. Stebbans, myself, I recall.

Q. Who is Mr. Stebbans?

A. Mr. Stebbans is the owner now of his own advertising agency; I believe it was Honig-Cooper Company at that time. He is an advertising man.

Q. That was the advertising agency for Schalk at that time?

A. For Schalk Chemical Company at that time.

Q. And Mr. Stebbans was representing that agency at that time? A. That is correct.

Q. Did that conference last several days?

A. It lasted two or three days, yes.

Q. Was a memorandum made of that conference?

A. Yes, Mr. Fulmer prepared a memorandum of that conference.

Q. And do you know when he prepared that?

A. Well, yes, he made his notes during the conference and prepared it at Schalk Chemical Company's office, dictated it immediately after the meeting.

(Testimony of Gerald I. Farman.)

Q. Did he give you a copy of the memorandum?

A. Yes; he did.

The Clerk: Petitioners' Exhibit No. 33 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 33 for [339] identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioners' Exhibit No. 33 for identification and ask you if that is the memorandum which you referred to? A. It is.

Q. Have you read this memorandum recently?

A. No; I haven't recently, I don't believe.

Mr. Hall: Your Honor, shall we take a recess?

The Court: There will be a short recess.

(Short recess taken.)

Mr. Hall: I offer this document as Petitioners' Exhibit No. 33.

Mr. Gardner: If the Court please, the respondent objects to the introduction of that document solely for the reason that the document was prepared by Mr. Fulmer, and Mr. Fulmer is the person who should identify the document and possibly be interrogated on the completeness, accuracy, and when these statements were recorded.

Now, we have no opportunity to do that and the document is hearsay.

Mr. Hall: I appreciate that, your Honor; Mr. Fulmer lives in Iowa or some place back east and

(Testimony of Gerald I. Farman.)

I am just trying to save some time. Mr. Smith certainly has some idea as to the authenticity of that document. Now, if we want to spend time going over it when Mr. Smith testifies, fine. [340]

The Court: Was Mr. Farman present at the meeting covered by this document?

The Witness: I was, sir.

The Court: What is the purpose of the offer?

Mr. Hall: It shows the discussion of products, it shows some decision on products that were not thereafter produced by Schalk. It shows that there was an endeavor to set up new management policies and effect them.

The Court: I will admit it.

The Clerk: Exhibit No. 33.

(The document heretofore marked Petitioners' Exhibit No. 33 for identification was received in evidence.)

Mr. Hall: Your Honor, I refer to Paragraph 7 of the Stipulation of Facts, Paragraph 7 refers to a stipulation and agreement dated September 26, 1929. I call the Court's attention to the fact that that stipulation and agreement is contained in Respondent's Exhibit J, Volume 4 of the Minute Books of Schalk, set forth at Pages 67 to 88. The declaration of trust which is Petitioners' Exhibit No. 1 also is set forth in Respondent's Exhibit J at Pages 89 to 104, and there are also set forth in the Minute Books some collateral agreements relating to the declaration of trust and the stipulation and agree-

(Testimony of Gerald I. Farman.)

ment. Now, with regard to the executive committee, your Honor, I call the Court's attention to Page 271 which is part [341] of the minutes of the meeting of the Board of Directors on September 26, 1945; commencing on Page 271 is the resolution which sets up the executive committee and sets out the powers of the committee and voting rights and so forth. Mr. Gardner, will you stipulate that Mr. Stanley W. Guthrie is dead?

Mr. Gardner: So stipulate.

Mr. Hall: I will state for the record that Mr. Guthrie passed away in 1952. I call the Court's attention to the fact that as shown in Respondent's Exhibit J, that Mr. Guthrie attended practically every meeting, I think there were a couple that he didn't, of Schalk Chemical Company from May 18, 1942, up to the time of his death in 1952.

The first meeting which he attended is at Page 147 of Respondent's Exhibit K. Now, on cross-examination Mr. Gardner asked this witness some questions regarding whether the outstanding stock of Schalk Chemical Company was owned by Horace O. Smith, the father of Horace O. Smith, Jr.

The Clerk: Petitioners' Exhibit No. 34 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 34 for identification.)

Mr. Hall: Petitioners' Exhibit No. 34 for identification is an amended inventory and appraisal in the matter of the Estate of Horace O.



(Testimony of Gerald I. Farman.)

Smith, Deceased, which amended inventory was filed on October 3, 1929. This is the copy, it is not a certified copy. [342]

The Court: I would conclude from Exhibit 1 and the matters referred to in Exhibit 1 that all of the shares of Schalk Chemical Company came from the estate of Mr. Smith, Senior.

Mr. Hall: That is not true, your Honor.

Mr. Gardner: That was my understanding.

Mr. Hall: But it is not true.

The Court: Very well, I will let you clarify the record, then.

Mr. Hall: I offer this as Petitioners' Exhibit No. 34.

Mr. Gardner: I have no objection.

The Court: Admitted.

(The document heretofore marked Petitioners' Exhibit No. 34 for identification was received in evidence.) [343]

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### Recross-Examination

By Mr. Gardner:

Q. Just two or three brief questions, Mr. Farman; Exhibit No. 10 shows the net profit before taxes for the Schalk Chemical Company from the period 1937 to 1957, does it not, sir?

A. It does.

Mr. Hall: May I ask Mr. Farman a question, Mr. Gardner?

(Testimony of Gerald I. Farman.)

Mr. Gardner: Surely.

Mr. Hall: Have you seen that before this time, Mr. Farman?

The Witness: No; I have not.

Mr. Hall: For the record, this exhibit was sponsored by Mr. Britton.

Mr. Gardner: Are you through?

Mr. Hall: Yes. [350]

Q. (By Mr. Gardner): Now, I believe that you testified that you took over in January of 1948, is that correct, Mr. Farman?

A. That is correct; January 15, 1948.

Q. And from that time on you ran the company, is that correct, sir?      A. That is correct.

Mr. Hall: Your Honor, I object to this line of questioning as not being any part of the redirect examination, and any questions pertaining to the profit in those years should have been addressed to Mr. Britton who prepared that exhibit. Mr. Farman has not testified on it either in his direct examination or in his redirect examination.

Mr. Gardner: He has testified as to his qualification as a manager, if the Court please, and I believe that that is involved here.

The Court: You may continue.

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): Now, I believe there was some testimony to the effect that Horace O. Smith, Jr., was making, what was it, \$500.00 a month in 1945, sir, was that your testimony?

A. That was my testimony.

(Testimony of Gerald I. Farman.)

Q. \$500.00? A. That was. [351]

Q. And that was as president and supervisor of Schalk, is that correct, sir?

A. Supervisor of the trust.

Q. Yes, and also president of Schalk, wasn't it?

A. As president of Schalk is all I know; I don't know anything about what he received as supervisor of the trust.

Mr. Hall: May I note for the record, your Honor, that the declaration of trust and the stipulation and agreement back of it provide that the trustee, the supervisor of the trust, shall receive no compensation as supervisor?

Mr. Gardner: Very good.

Q. (By Mr. Gardner): Now, then, also during the period that Horace O. Smith, Jr., was supervisor of the trust, as I understand it, there were dividends declared every year, is that correct, sir, up to 1947?

A. Yes; well, I can't, I assume they were, I am not positive, I haven't the records in front of me, but I believe that every year a dividend was paid.

Q. I believe you testified also that from the time you took over there have been no dividends, is that correct, sir? A. That is correct.

Q. Would you tell me, sir, what your salary was in 1948 when you took over as president of Schalk?

A. No; I cannot. [352]

Q. Was it as much as the prior president, Mr. Smith, Jr., had been receiving?

(Testimony of Gerald I. Farman.)

A. Yes; I imagine it was more than that, I don't know; I cannot tell you.

Q. All right, let's go on up to 1950; do you recall what your salary was, sir?

A. I don't recall it at all, sir.

Q. Do you recall what it is in 1958?

A. Yes.

Q. How much is it, sir?

A. My salary as president of Schalk Chemical Company is \$12,000.00 a year.

Q. Is Mrs. Farman also an officer?

A. She is vice president and treasurer of the company.

Q. What is her salary, sir?

Mr. Hall: I object, your Honor, as not being proper examination at this time. Mr. Gardner could have covered these subjects earlier.

The Court: He may continue.

The Witness: Her salary at this time?

Q. (By Mr. Gardner): Yes.

A. As I recall, it is \$450.00 a month.

Q. Now, has she received more than that during any period from 1948 to the end of 1958? [353]

A. More salary than that?

Q. Yes. A. Not as a salary.

Q. Does she receive any other income?

A. She has received bonuses.

Q. How much?

A. I have no idea; employee bonuses.

Q. Are they substantial bonuses?

A. Some years they were good bonuses, other

(Testimony of Gerald I. Farman.)

years we didn't even take a bonus when we paid the employees bonuses, we did not take bonuses ourselves.

Q. What would you consider a good bonus?

Mr. Hall: I object, your Honor, on the ground that this line of questioning is immaterial to the issues of this case. The question of reasonableness of salaries or reasonableness of bonuses or the fact that this management paid certain salaries or does not, or that it pays bonuses or it does not has nothing to do with this case. It is immaterial.

The Court: What is the purpose, Mr. Gardner?

Mr. Gardner: Well, if the Court please, in the first place it has nothing to do with this case as he says, yet this Exhibit 10, I note, is petitioners' exhibit, petitioner has introduced the profit throughout these years, petitioner has placed this in issue. Now, I would like to find out a little [354] more about this.

The Court: Placed what in issue?

Mr. Gardner: The years 1950, 1951, 1952 and up to 1957.

The Court: I think you are getting a bit remote, Mr. Gardner.

Mr. Gardner: Well, that may be; what I would like to do, your Honor, is show that this witness and Mrs. Farman are the only ones who are receiving anything from this corporation; dividends have been eliminated.

Mr. Hall: That is immaterial to the issues in this case, your Honor.

(Testimony of Gerald I. Farman.)

Mr. Gardner: And in that respect, your Honor, once again we are involved with a personal interest rather than a corporate interest. That is the issue in this case.

The Court: You have already established their present salaries, and the fact that no dividends have been declared has already been testified to. I think you have sufficiently exhausted that subject.

Mr. Gardner: All right. The only thing I haven't gotten into is the question of the bonuses and they could be substantial or not.

The Court: You may ask him what the range of the bonuses was.

Mr. Gardner: Thank you, your Honor. [355]

Q. (By Mr. Gardner): Would you state for the Court what is the range of the bonuses received by you and Mrs. Farman during the years——

A. They are set by Mrs. Farman and I never—— they are set by the Board of Directors; I am sorry if I misunderstand——

The Court: Let's not quibble; what was the range of the bonuses that you and Mrs. Farman received?

The Witness: When we did receive bonuses, the highest I recall was \$3,000.00 each; many of them, several of them probably a thousand and in some years we did not take any bonuses ourselves, the employees received bonuses.

Q. (By Mr. Gardner): But you have received as high as \$3,000.00 each?

A. To my best recollection, yes, Mr. Gardner.

(Testimony of Gerald I. Farman.)

Mr. Gardner: If the Court please, I have one request of the Court; I have no further questions of this witness at this time. We attempted to arrange, that is, between counsel for petitioner and myself, a chance to share the wealth, so to speak, on the minute books over the week end. Counsel was very busy and was unable to relinquish the minute books. Now, I am going to attempt to study them tonight if counsel has no objection and I would like an opportunity to—I don't want this witness excused, I may want to recall him. I request the Court's permission at this time to do that. I can't say that my cross-examination is completed until I have gone over those minute books [356] carefully.

Mr. Hall: I take it, then, Mr. Gardner, you expect to go over until tomorrow anyway on the trial of this case?

Mr. Gardner: I should imagine it would, Mr. Hall.

Mr. Hall: I mean, you would proceed in the normal course, or are you asking for a recess until tomorrow morning?

Mr. Gardner: No; I am not asking for a recess. What I am asking is that this cross-examination right now be discontinued until such time as I can look those over tonight and then there may be no questions at all, your Honor.

Mr. Hall: It is satisfactory to me to have Mr. Gardner look over the minute books which are in evidence.

(Testimony of Gerald I. Farman.)

(Discussion at the bench off the record.)

Mr. Hall: I state for the record, your Honor, that Mr. Farman will be available throughout this trial and if there are any further questions, Mr. Gardner wants to put to him, we will be happy to have him resume the stand.

#### Further Redirect Examination

By Mr. Hall:

Q. Mr. Farman, were bonuses customarily paid by Schalk Chemical Company to the president and other officers of the company prior to 1948?

A. They were.

Q. In 1946, was a bonus paid to you as a vice president? A. It was.

Q. Do you recall the amount of that [357] bonus?

A. As I recall, it was \$1,200.00.

Q. Was a similar bonus paid to Mrs. Farman at that time? A. It was.

Q. Mr. Farman, I show you Respondent's Exhibit K which is Volume 5 of the Minute Books of Schalk Chemical Company, minutes of January 15, 1948, meeting of the Board of Directors, Page 27 of the volume, where it states, "Resolved that the salary of the president, G. I. Farman, shall be \$500.00 per month commencing January 15, 1948."

Does that refresh your memory as to what your salary was?

A. It does; I didn't know what my salary was.



Mr. Hall: I have no further questions.

Mr. Gardner: I have no further questions at this time.

Mr. Hall: Then I have no further questions at this time.

(Witness excused.)

Mr. Hall: I call Mrs. Baker.

PATRICIA FARMAN BAKER

a witness called by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address, please?

The Witness: Patricia Farman Baker, 94 Esperanza Street, Sierra Madre.

Direct Examination

By Mr. Hall:

Q. Mrs. Baker, are you one of the petitioners in this [358] proceeding? A. I am.

Q. We have here as Petitioners' Exhibit 1 a declaration of trust in which is named a Patricia Smith; are you Patricia Smith? A. Yes, sir.

Q. Mrs. Baker, I hand you Petitioners' Exhibit 16 which is an agreement dated January 15, 1948, between Horace O. Smith, Jr., First Party, and Hazel I. Farman, Evelyn Smith Marlowe and Patricia Farman Baker.

This agreement I will refer to as the settlement

(Testimony of Patricia Farman Baker.)

agreement. Did you sign that agreement, Mrs. Baker?      A. Yes; I did.

Q. Does your signature appear on there?

A. Yes, it does.

Q. Now, Petitioners' Exhibit No. 16, Mrs. Baker, states that \$25,000.00 was paid to Mr. Smith at the time of that agreement. Did you pay any part of the \$25,000.00?      A. Yes.

Q. How much?      A. \$5,000.00.

Q. And where did the \$5,000.00 come from, Mrs. Baker?

A. We borrowed it from my father-in-law, Walker H. Baker.

Q. By "we," who do you mean? [359]

A. Mr. Baker.

Q. John Harvey Baker?

A. That is right.

Q. He is also a petitioner in this proceeding, is that correct?      A. Yes.

Q. When did you marry Mr. Baker?

A. In 1943.

Q. 1943?      A. Yes.

Q. Now, the \$5,000.00 was borrowed, you say?

A. Yes.

Q. From whom?

A. Dr. Baker, Mr. Baker's father.

Q. Did you give Dr. Baker a note for the loan?

A. We did.

Q. Was the note later repaid?      A. It was.

Q. Do you recall when it was repaid?

A. 1950, '51.

(Testimony of Patricia Farman Baker.)

Q. Do you recall what funds you used to repay that note, where you got the funds that you used to repay that?

A. I suppose from our mutual, what we had together, I don't recall exactly.

The Clerk: Petitioners' Exhibit 36 for identification. [360]

(The document above referred to was marked Petitioners' Exhibit No. 36 for identification.)

Q. (By Mr. Hall): Mrs. Baker, I hand you Petitioners' Exhibit No. 36 for identification, and ask you if this is the copy of the note that you gave to Dr. Baker? A. Yes; it is.

Q. When this note was repaid, was the original returned to you?

A. I don't know what happened to the original. I imagine it was destroyed.

Q. Well, have you conducted a search for it?

A. Yes; I have.

Q. But you were unable to find it?

A. I couldn't find it.

Mr. Hall: I will say for the record, your Honor, that this came from the files in the law firm of which I am privileged to be a member. I offer this as Petitioners' Exhibit No. 36.

Mr. Malone: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked Petitioners' Exhibit No. 36 for identification was received in evidence.)

(Testimony of Patricia Farman Baker.)

Q. (By Mr. Hall): Are you working at the present time, Mrs. Baker? [361] A. Yes.

Q. Where are you employed?

A. Schalk Chemical Company.

Q. How long have you been employed at Schalk Chemical Company? A. Since 1950, '51.

Q. In what capacity are you employed by Schalk Chemical Company?

A. General office work.

Q. By general office, what duties do you have?

A. Well, I do a little of everything, purchasing, bookkeeping, a little bookkeeping, credit, posting, just about everything.

Q. Mrs. Baker, I hand you again Petitioners' Exhibit No. 16 which was the settlement agreement with Mr. Smith. Would you state for the Court what was your, what your purpose was in entering into that agreement?

A. Well, my purpose was, and it was shared by my mother and sister, was to end the dissension which had gone on for several years over the policies and management of the corporation, and so that the company could prosper and grow.

Q. Did you at any time have any desire to acquire any part of Mr. Smith's stock interest?

A. Well, hardly. It would have amounted to approximately, I guess it would have amounted to one-thirtieth [362] of my stock interest.

Q. One-thirtieth of what, Mrs. Baker?

A. Well, it would have added that much to my

(Testimony of Patricia Farman Baker.)

stock interest and he could have kept his stock, I wasn't interested in it in the least.

Q. Now, the \$5,000.00 that you paid to Mr. Smith, did you expect to receive that back, Mrs. Baker?

A. Well, yes; I thought—it was just like loaning it to the corporation, that it should be paid back when the company was back on its feet.

Mr. Hall: You may examine.

Cross-Examination

By Mr. Malone:

Q. Mrs. Baker, I believe you stated that you are a petitioner in this case, is that true?

A. That is true.

Q. Do you have an ownership interest in the Schalk Chemical Company? A. Yes; I do.

Q. And what is that interest?

A. One-sixteenth, I believe it is.

Q. One-sixth? A. One-sixteenth.

Q. One-sixteenth?

A. I think that is correct; I am not sure. [363]

Q. Well, how many shares of stock in the company do you own? Do you know how much that is?

A. I don't—

Mr. Hall: Your Honor, we will stipulate that Mrs. Baker owns 16,667 shares.

Q. (By Mr. Malone): Mrs. Baker, do you know how many shares of stock in the Schalk Chemical Company are outstanding?

A. That same amount that I have.

(Testimony of Patricia Farman Baker.)

Q. Well, do you know who else owns interest in the Schalk Chemical Company?

A. My mother and my sister.

Q. Your sister, does she own the same amount of interest that you own?      A. That is right.

Q. How much does your mother own?

A. My mother owns 50 per cent.

Q. Fifty per cent, do you mean she owns 50,000 shares?      A. I suppose so, yes.

Q. Do you know how much stock is outstanding of the corporation, how much the total amount of stock?

Mr. Hall: I stipulated, your Honor.

The Court: He is entitled to find out from this witness what she knows.

The Witness: 16,000, the same amount that I have, [364] 16,666 shares.

Q. That is the amount of stock that you understand to be outstanding for Schalk Chemical Company?      A. Yes.

Q. How long have you owned this stock, Mrs. Baker?      A. Well, I have always had it.

Q. That is to say you have always had an interest in the Schalk Chemical Company?

A. That's right. I have always had an interest.

Q. Has it always been in this amount?

A. No; when my grandmother died, my paternal grandmother, the trust was still in existence and I believe that part of that was divided between my brother and my sister or that all of it was divided between my brother and my sister and myself.

(Testimony of Patricia Farman Baker.)

Q. Do you remember how much this interest was?

A. The same amount as we each had, each 16,666.

Q. You stated—have you depended upon Schalk for your livelihood by way of salary or dividends?

A. By way of salary.

Q. For how long?

A. Since I have been working there, 1951.

Q. Is that 1950 or 1951?

A. It could have been 1950 or it could have been 1951; it was approximately around there.

Q. Well, before 1950, you did not work for Schalk in [365] any way? A. No.

Q. Were you acquainted with the business?

A. Yes.

Q. In what respect?

A. Well, we were living at home at the time. This was when I was married and I was very well acquainted with what was going on.

Q. Well, what do you mean by that, now? Did you go down to the business every day?

A. Not every day; on occasion.

Q. Did you go down at all?

A. On occasion.

Q. What were those occasions?

A. Oh, I went down with my mother when she went down, I don't know that there was any particular occasion to go.

Q. What did you do when you went down?

A. When I went?

(Testimony of Patricia Farman Baker.)

Q. Yes.

A. I don't remember that; I just went with my mother and stayed and waited for her.

Q. I see. At the times that you went down to the company you sat in the waiting room until your mother was through?

A. There isn't a waiting room as such; I just found a [366] chair and sat down in the office.

Q. You did not have any business, then, to do when you went down there?

A. I wasn't working; I was married then.

Q. Did you have anything at all that you would be inquiring about, was the purpose strictly to accompany your mother or was it for any other purpose of your own?

A. It was not for any particular purpose of my own other than I wanted to sort of be a help Mother if she needed it, she wasn't received very well at that time down there.

Q. Do you know why your mother went down there?

A. She was working there for awhile.

Q. What periods were those?

A. Let's see, well, 1946, 1945 and '46 and '47.

Q. Well, prior to the time you were employed by Schalk, you received money from the company by way of dividends?      A. Yes; I did.

Q. Did you receive this money regularly?

A. Yes.

Q. Every year you received a dividend?

A. I believe it was every year.



(Testimony of Patricia Farman Baker.)

Q. Do you recall about what your extent of the share of the dividends were? A. No; I don't.

Q. Was it a substantial amount? [367]

A. It was apportionate to my—

Q. Your interest? A. My interest.

Q. Was it a substantial amount, was it sufficient for you to live on? A. Well, no.

Q. Now, let's get this down to years. Now, for example, during 1949 did you receive dividends?

A. 1949, no.

Q. Well, now, in 1948 did you receive dividends, do you recall?

A. I don't believe so; I don't recall.

Q. 1947, did you receive dividends?

A. I don't think so.

Q. 1946, did you receive dividends?

A. Yes.

Q. Was it a substantial amount?

A. I believe it was; I couldn't say exactly how much.

Q. Was your share of the dividends more than \$2,000.00? A. I couldn't say.

Q. Was it less than \$2,000.00?

A. I don't know, I really don't; I would have to check.

Q. Well, during the year 1946, you were married at that time, were you not? A. Yes. [368]

Q. Was your husband providing your income at that time? A. Yes.

Q. Were you depending upon Schalk for any income at all?

(Testimony of Patricia Farman Baker.)

A. No, only—no, just the dividends, I wasn't depending on them as such, I couldn't have lived on them.

Q. Were you looking forward to receiving them?

A. Well, it is always nice to receive them.

Q. How about the year 1945, did you receive dividends?

A. I don't remember, I really don't; we probably did receive them every year for a long time.

Q. Well, in 1943, did you receive them, let's say before you were married did you receive dividends?

A. Yes.

Q. Do you recall the amounts of those dividends?

A. No; I don't; it didn't do me much good before I was married because then I was not of age.

Q. What was your age in 1943, may I ask?

A. 1943, I was 19.

Q. In 1944 you would be 20; 1947, what would be your age?      A. 1947, 24—23.

Q. You would be 22, wouldn't you?

A. 22, all right.

Q. While you were married you did not depend upon Schalk for your source of income, is that correct?      A. That is correct. [369]

Q. Do you know of your own personal knowledge as to the other members of your family, did they depend upon Schalk for their income?

A. No.

Q. What about Mr. Smith; do you know if he depended upon the company for his income?

(Testimony of Patricia Farman Baker.)

A. I suppose he did.

Q. And your sister, Evelyn Brown?

A. She was married.

Q. She did not depend upon Schalk for her source of income? A. No.

Q. What about your mother; did she depend upon the company?

A. Mother depended a great deal on it in some ways.

Q. What ways do you mean?

A. Well, I mean—I am sorry, I made a mistake. Mother didn't need—she didn't depend on it.

Q. She did not depend on it? A. No.

Q. Was she independently wealthy?

A. No.

Q. What did she depend on for her living?

A. My father.

Q. Who is that? [370] A. Mr. Farman.

Q. Is Mr. Farman your father?

A. He is my legal father.

Q. I see. Were you adopted?

A. Yes; I was.

Q. Do you know when that took place?

A. It was shortly after they were married. I was eight or nine or ten.

Q. You were quite a young child at that time?

A. Yes; I was.

Q. Well, have you ever been an officer of the Schalk Chemical Company? A. No; I haven't.

Q. Just an employee? A. That is right.

Q. Have you ever been a director? A. No.

(Testimony of Patricia Farman Baker.)

Q. What is your acquaintanceship with the business other than as an employee? Have you ever had a chance to look into the books and records of the business? A. Yes, I have.

Q. You have. When did you do this?

A. Well, I do it quite frequently.

Q. You mean you do it now?

A. Yes; I do a lot of the posting; I make out the [371] checks, occasionally I read a financial statement, but not always.

Q. You say you read a financial statement?

A. I look at one.

Q. What do you look at on the financial statement? A. I look at our profit.

Q. The net profit? A. Yes.

Q. Are there any other things to look at on a financial statement?

A. What we have spent for advertising, what the overhead is.

Q. Do you make a general analysis of the financial statement? A. Not as—no.

Q. Can you tell by looking at a financial statement the condition that the business might be in?

A. Well, I can tell whether it is making money or not.

Q. By the net profit? A. That is right.

Q. Can you tell whether a business is solvent by looking at its financial statement? A. Yes.

Q. You can, and what do you look at to determine whether the business is solvent or not? [372]

A. I am sorry—

(Testimony of Patricia Farman Baker.)

Q. You look to see whether there is a net profit or not, isn't that about it?

A. Yes; I look to see if there is a net profit.

Q. But actually you are not able to tell whether the business is solvent or not by looking at its financial statement?

Mr. Hall: I object, your Honor; the question is argumentative. The witness has stated she doesn't know really.

The Court: She may answer.

The Witness: Would you state the question again, please?

Q. (By Mr. Malone): Well, when you look at the financial statement, isn't it the case that you just look to see whether there is a profit or not; you are not able to tell whether its business is solvent or not?

A. Well, I am down there enough; I have a pretty good idea of whether we are solvent or not. The bill collectors aren't coming around; we have a good rating in D and B.

Q. Are those the things which to you mean the company is solvent?

The Court: Are you asking her about her present knowledge of the enterprise or are you, do you want to find out what she knew about it at the time these transactions were entered into?

Mr. Malone: I am trying to test the basis for the [373] witness' belief as to her ability to evaluate the business, your Honor. She may do that as of now or as of any other time.

(Testimony of Patricia Farman Baker.)

The Court: I think you would make more progress if you would put your questions to her in terms of what she knew at that time.

Mr. Malone: Thank you, your Honor.

Q. (By Mr. Malone): Now, Mrs. Baker, did you know in 1947 whether the business was solvent or not?

A. In 1947 we lost money. I know this—I don't know, and I know we lost money in 1940, but at that time I was young and money didn't mean too much at that particular time as far as I was concerned. I was unhappy that the company had lost money.

Q. Did you know that the business was solvent, I believe that was my question.

Mr. Hall That calls for a conclusion of the witness.

The Court: I don't know what counsel means by the use of the word solvent anyhow. Suppose you reframe your question.

Mr. Malone: All right.

Q. (By Mr. Malone): Mrs. Baker, in 1947, did you know whether the corporation had sufficient current assets to meet its current liabilities?

A. I don't know. [374]

Q. Did you know whether the corporation had sufficient current assets to meet its current liabilities in 1946?

A. I don't know. My brother was in complete control at that time and he didn't share anything with any of us.

(Testimony of Patricia Farman Baker.)

Q. Did you ever look at any of the books and records at that time? A. No; I did not.

Q. Well, really then, you didn't know what was going on in the corporation financially, did you?

A. No; I didn't. [375]

\* \* \*

Redirect Examination

By Mr. Hall:

Q. Mrs. Baker, did you understand Mr. Malone's question on cross-examination when he asked you what was the outstanding stock of Schalk Chemical Company? A. No; I did not.

Q. You did not understand it?

A. I did not understand it.

Q. What is the outstanding stock of Schalk Chemical Company?

A. 100,000 shares; it was until the termination of the trust.

Q. And what has it been since the termination of the trust?

A. That less the stock acquired from my brother.

Q. Now, prior to the date of your marriage, to whom [376] were the dividends paid that we will say belonged to you?

A. To the guardian; to my guardian.

Q. Who was that? A. Mr. Colyear.

Q. Curtis C. Colyear? A. That is right.

Q. He was also the supervisor of the trust, is that correct? A. That is right.

(Testimony of Patricia Farman Baker.)

Q. Mr. Malone asked you some questions regarding your knowledge of the affairs of Schalk Chemical Company prior to the time that you were employed by Schalk Chemical Company. Now, as I recall, you said you were employed in 1950 or 1951.

A. Yes.

Q. Prior to 1948 did you participate in any meetings between the family and Mr. Smith?

A. Yes; from 1955 on.

Q. What was the answer, please? A. Yes.

Q. What year did you say?

A. From 1955 on, after 1955.

Q. Do you mean 1945?

A. I am sorry, 1945.

Q. And could you approximate the number of meetings that were held between the family and Mr. Smith, and say what [377] period of time you are talking about? A. Well, I—

Q. Just roughly.

A. Oh, there must have been many, many meetings, numerous meetings.

Q. Would you say there were more than 50 meetings in the period 1945 to 1948?

A. Oh, yes; at least that many.

Q. Where were these meetings held normally?

A. Various places, at home, at my parents' home, at Mr. Guthrie's office.

Q. And were you living with Mr. and Mrs. Farman in 1945? A. Yes.

Q. Was your husband also living with them?

A. Yes.



(Testimony of Patricia Farman Baker.)

Q. And there were meetings held at the home, is that correct?      A. That is right.

Q. And what did these meetings concern?

A. Well, they concerned trying to reach some kind of a settlement with Mr. Smith, my brother, or to get him, to have him co-operate with the family and all of us in general.

Q. Were the affairs of the corporation discussed at those meetings? [378]      A. Certainly.

Q. What matters were discussed at those meetings affecting the corporation?

A. New products, the need for new products, a building which was needed in the east because ours was not adequate, and the business in general.

Q. And there were meetings in Mr. Guthrie's office, is that correct?      A. Yes.

Mr. Hall: You may examine.

Recross-Examination

By Mr. Malone:

Q. Now, Mrs. Baker, in regard to these meetings, they were held to discuss the matters involved as to management; was there any discussion at these meetings as to whether or not you might sell your interest in the company?

A. I don't remember.

Q. Were there any discussions at these meetings regarding the sale of the company completely to outsiders, for example?

A. There could have been, but I couldn't say definitely that there were.

(Testimony of Patricia Farman Baker.)

Q. Well, can you say that there were not?

A. No; I don't remember this part of it.

Q. These meetings that you had, did you participate [379] in them?

A. No; not to any extent.

Q. Did you make any suggestions?

A. I am sorry; we all had ideas of products that we thought should possibly be considered. My ex-husband did, my sister did, and I was quite young at the time but even I did.

Q. You had ideas?

A. Ideas, yes; I can't think of what they were right now; I did.

Q. Well, in regard to the—what was the consequence of these meetings, were you able to work out an arrangement that changed the company management?

A. No. My brother would not co-operate with any of us at the time. He wanted full control which he had and exercised.

Q. Did you take any action subsequent to these meetings with respect to instituting litigation in this case?

A. There was—we brought action against him, yes.

Q. There was a suit filed? A. Yes.

Q. Were you a party to that suit?

A. I don't know what you mean by party to it.

Q. Were you involved, were you named in the action?

A. I don't recall whether I was or not, but I

(Testimony of Patricia Farman Baker.)

was a party to it in—how can I word it, I was for it at the time.

Q. Did you suggest it at the outset? [380]

A. Did I suggest it?

Q. Yes.

A. No; I was, it was a mutual thing that we agreed to.

Q. Who suggested it?           A. I don't recall.

Q. You don't recall, but you did not?

A. No.

Q. When did this occur, these discussions at which time there was talk about instituting this action?           A. I don't remember.

Q. Was it in 1947?           A. I don't remember.

Q. Was it in 1946?

A. I don't remember the year, sir, that it happened, that we brought the suit, I am sorry, I can't say.

Q. But you did have meetings before the suit was brought at which you were in attendance?

A. We had meetings from 1955, on—1945 on, I am sorry.

Q. Did you have any suggestions as to the matters that should be brought up in the litigation which subsequently followed?           A. No.

Q. Do you know what matters were brought up in the litigation?

A. I am sorry, I don't. [381]

Q. Do you know that there were eleven causes of action filed against Mr. Smith?

A. I am sorry, my memory isn't that good.

(Testimony of Patricia Farman Baker.)

Q. You do not know, do you have any idea how many causes of action were filed?

A. Did you say eleven were?

Q. I asked you if you know whether eleven were or not.

A. No, I don't recall the number of actions.

Q. Do you know that it was more than one action, more than one cause of action was alleged in the complaint?

A. I don't know, sir.

Q. Do you know whether Schalk Chemical Company was named in the complaint?

A. I don't know that, either.

Q. Did you sign the complaint?

A. I imagine I did.

Q. Well, at that time were you familiar with its contents?

A. At that time I probably was, yes, I don't sign things unless I am familiar with the contents.

Q. Then you had read the complaint?

A. Yes, I had.

Q. At that time you knew what was in it?

A. That is right.

Q. Were any of the matters complained in the complaint [382] at the time, were any of them suggested by you as causes of action that should be brought?

A. I doubt it.

Q. Who was it that suggested the causes of action?

A. I have no idea; we had attorneys, they probably suggested it.

(Testimony of Patricia Farman Baker.)

Q. Did Mr. Farman suggest any of the matters that should be brought in the suit?

A. I don't know.

Q. Was he present at any of these meetings?

A. Yes, he was.

Q. Did he take an active part?

A. Yes, he did.

Q. In respect to making suggestions, did he do that as to what should be brought in the complaint against Mr. Smith?

A. He probably made suggestions, but we had to agree to them.

Q. Did you make any of these suggestions?

A. No, I did not.

Q. Do you recall having made any suggestions to Mr. Farman?

A. I don't recall; possibly I did, I don't know, I can't recall.

Q. Well, the case was really, you were looking to him for advice and counsel in that respect, weren't you following [383] his advice as to what should be raised as to your complaint?

A. I follow my father's advice, but I also have a mind of my own, and I do what I think is right.

Q. Another question, Mrs. Baker, prior to 1945 did you have any business experience with respect to any kind of industry or business?

A. Prior to 1945?

Q. Yes.

A. Well, I got married at 19 and I was just out of school.

(Testimony of Patricia Farman Baker.)

Q. And during the time you lived with your parents and your husband, your husband provided your living for you, is that correct?

A. That is correct.

Q. Now, prior to 1947 have you had any business experience?

A. Prior to 1947 I helped my husband only in typing reports for him and in his things I could do for him at home is all.

Q. What was his work?

A. He was an engineer.

Q. I see. For whom was he employed?

A. Well, he first, when I married him, was working for Aerojet Engineering, then he went into the Navy, was in the Navy for a year and a half, or a year, then he came out and [384] went to work for Elcon, I believe it is, Elcon Manufacturing Company.

\* \* \*

Mr. Hall: Mr. Bradley.

### EARL F. BRADLEY

a witness called by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address for the record, please?

The Witness: Earl F. Bradley, 2101 Medial Drive, Los Angeles 49.

(Testimony of Earl F. Bradley.)

Direct Examination

By Mr. Hall:

Q. Mr. Bradley, what is your occupation, please?

A. I am a salesman for Schalk Sales Company.

Q. How long have you been employed by Schalk Sales Company?      A. Thirty-five years.

Q. Do you mean Schalk Sales Company or Schalk Chemical Company?

A. Schalk Chemical Company.

Q. You have been employed by Schalk Chemical Company for 35 years? [385]      A. Yes, sir.

Q. As a salesman?      A. Yes, sir.

Q. Do you have a territory today, Mr. Bradley?

A. Yes.

Q. What territory is that?

A. I work the Los Angeles area and Arizona.

Q. Los Angeles and Arizona?

A. Yes, and San Diego.

Q. How long have you had that territory?

A. Since 1947.

Q. Since 1947?      A. Yes.

Q. Now, prior to 1947 what territory did you handle for Schalk Chemical Company?

A. I worked all the middle western states.

Q. Did that territory have a name?

A. Central District, I think they called it; it was from Chicago to Minneapolis.

Q. What states did the Central District cover?

A. Illinois, Wisconsin, Minnesota, North Dakota,

(Testimony of Earl F. Bradley.)

South Dakota, Nebraska and Missouri, part of Indiana, too.

Q. Prior to that time, prior to the time that you came here to take over the Los Angeles-Arizona territory, how long had you had the territory in the mid-west? [386]

A. From 1923 to 1947.

Q. 1923 is the year you were first employed by Schalk Chemical Company?

A. I started in March.

Q. Now, in servicing or performing your sales work for Schalk Chemical Company in this mid-west area prior to 1947, what were your duties, Mr. Bradley?

A. I called on paint, hardware and lumber yards, paint jobbers, paint manufacturers, hardware jobbers and lumber yards, with the Schalk products.

Q. And that necessitated, did it, being on the road quite a bit?

A. Quite a bit, I was probably on the road half the time.

Q. Where did you reside at that time?

A. Chicago.

Q. You resided in Chicago at all times prior to 1947?

A. Yes.

Q. And you would be on the road approximately how long each year?

A. Oh, probably seven months each year, or six months.

Q. How long would it take you to make the circuit of your territory?

A. It would all depend on what trip you would



(Testimony of Earl F. Bradley.)

make, some trips would take two weeks, some would take three weeks, [387] when I went to Chicago, to Minneapolis, it would take about two weeks, up to Kansas City would take longer, about three weeks.

Q. How many times a year would you contact your accounts? A. About three times.

Q. In other words, you were on the road most of the year but you weren't off the road for six months, were you, sir?

A. Well, when I was off the road I worked around Chicago.

Q. I see. Now, at any time during your employment with Schalk Chemical Company have you been assigned to work not as a salesman but work in the factory in Chicago? A. Yes.

Q. When was that?

A. That was in 1946, I think, I was in the factory for about four or five months, probably six months.

Q. What circumstances existed in Chicago at that time that occasioned the fact that you were working in the factory?

A. There was a terrific backlog of orders in the company, there was a shortage of help in the factory. There didn't seem to be any point in going out trying to get more business when you didn't have material to fill the orders that you had on hand.

Q. And how long were you working in the factory at [388] that time?

A. As near as I can recall, it was about six months.

Q. What did you do in the factory?

(Testimony of Earl F. Bradley.)

A. Well, we packed material.

Q. What did you do personally?

A. Well, I kind of worked as a team there with two other salesmen and we run the machines, the automatic Double X machine, we called it, then we had to help in the shipping, we were generally busy.

Q. Well, did you work every day, Mr. Bradley?

A. Every day, yes, not a full eight hours every day.

Q. Well, would you work only a half a day?

A. Sometimes we worked a half a day.

Q. Then would you go home?           A. Yes.

Q. Were attempts being made at that time to secure materials to round out the production, make it full production?

A. Well, there was a manager in charge, I imagine he did, I don't know, he was in the factory most of the time when we were there, what he would do at other times I don't know.

Q. Well, what about orders you had obtained, Mr. Bradley, were they current?           A. Oh, yes.

Q. They were not backlog?

A. Well, the orders that came in were backlogged. [389]

Q. How far were your orders backlogged?

A. Some six or seven months, some of them were almost a year old.

Q. Prior to that time what had been your experience concerning the amount of time elapsing between the time that you placed an order and presented it to the company and the time the company

(Testimony of Earl F. Bradley.)

filled it? A. Before this backlog?

Q. Yes.

A. They would generally go out the same day.

Q. Now, while you were working in the factory did you observe the receipt of orders for shipment of products?

A. We would see them come in in the morning.

Q. What was done with those orders?

A. They would stamp them, the date received, and then put them in the drawer, put them on the bottom of the pile.

Q. How many orders were accumulated in this pile that you mentioned?

A. I think there were over 700, I know we counted them once and there was close to a thousand, I think.

Q. This was in 1945 or 1946? A. Yes.

Q. After the expiration of this period, you went back on the road, is that correct? A. Yes. [390]

Q. And at that time there was plenty of products to sell, is that correct? A. Yes.

Q. Now, you have had over 35 years of experience selling the Schalk lines, as I understand it?

A. Yes.

Q. Prior to World War II what was your opinion of the Schalk line?

A. Well, I was very enthusiastic about it, good products, they did a good job, they were well received.

Q. Did this opinion change?

(Testimony of Earl F. Bradley.)

A. In reference to the products, no.

Q. Well, was there any trend that you observed?

A. Well, I noticed, I began to notice that the sale of Double X was dropping off.

Q. When was this?

A. Probably started some time in the late 30's.

Q. Was this of concern to you personally?

A. Yes, it was.

Q. Why?

A. Well, it was our leading article in money value, point of sale, it was the item that the salesmen could do the biggest volume with and make the most money out of.

Q. What market conditions prompted the decline, in your opinion? [391]

A. It was a slowly changing picture, sanding machines, the sanding machine manufacturers began to put sanding machines in paint and hardware stores for rental, the homes began to put in wall-to-wall carpeting, eliminating the use of recleaning the floor, and asphalt tile came along, it was a picture that has changed considerably in the last few years; where there once was ten wooden floors in a ten room home, now there would be only one or two.

Q. What was your own opinion in this field?

A. I thought that we would have to have something to boost the sales in Double X, we needed new products, something to take its place.

Q. Did you recommend any new products to Schalk?

(Testimony of Earl F. Bradley.)

A. Specifically I mentioned one or two to Mr. Fulmer who was in charge of the Chicago office.

Q. When was this, Mr. Bradley?

A. I don't know the exact year, but when I noticed the sale of Double X began to bog down.

Q. Was any action taken on your recommendations?

A. Well, I don't know, when I would mention these things to Mr. Fulmer he would say well, I will take it up with the main office.

Q. Well, were any of the products you suggested marketed?

A. A long time after I recommended them. [392]

Q. By Schalk Chemical Company? A. Yes.

Q. What products were they?

A. One was a wallpaper grease spot remover, a plastic pencil, the pencil for filling cracks in walls made out of plastic material, called a plastic pencil.

Q. Were the market conditions, as far as Schalk is concerned, changed by World War II?

A. I don't know quite what you mean.

Q. Well, was your personal concern with the situation changed by reason of World War II?

A. Well, I felt if some change, if some new products hadn't been offered that with Double X drying up you wouldn't have anything to sell during the war or after the war.

Q. Did the war change the picture in your opinion?

A. Oh, yes, the war helped in this way, that a lot of jobbers, people we hadn't sold anything to before

(Testimony of Earl F. Bradley.)

were trying to find merchandise to sell, so they were trying to stock our items. For instance, I had a couple of ship chandlers that never sold anything of ours until the war came along, and then they were desperate for items to sell so they were trying to get our line.

Q. You testified earlier there was a shortage of materials in 1945 and 1946; was there a shortage of any other essential supplies? [393]

A. Shipping containers.

Q. What do you mean by shipping containers?

A. The cardboard box that you put the merchandise in.

Q. How about cans?

A. There was a shortage of cans, too.

Q. Did you assist in procuring cans for Schalk Chemical Company in 1946?

A. I did in an indirect way.

Q. What did you do in that regard?

A. I took Mr. Farman up to the American Can Company in Chicago and introduced him to a man who had been a former associate of mine; I worked for the American Can Company, and told him the situation we were in and he got some cans for us.

Q. When did you work for American Can Company?      A. 1921 or 1922.

(Testimony of Earl F. Bradley.)

Cross-Examination

By Mr. Gardner:

Q. Mr. Bradley, referring to the period 1946 when you worked in the Chicago plant, that was a rather unusual situation, wasn't it, sir?

A. It was.

Q. What was the reason that there was such a backlog of orders, could you tell me, sir?

A. We didn't have the material to fill them; they were coming in faster than you could get raw material to [394] formulate these products, I guess.

Q. You were having difficulty obtaining the raw materials, sir, and you would place these orders, I suppose many months back, but still hadn't received the shipment or fulfillment of your orders, is that right?

A. That's right.

Q. That was, in other words, would you say, sir, that was a situation that was common in 1946?

A. I imagine.

Q. Everybody was having difficulty obtaining supplies, weren't they, sir?

A. I imagine. [395]

\* \* \*

Mr. Gardner: Mr. Smith.

## HORACE O. SMITH, JR.

a witness called by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address, please?

The Witness: Horace O. Smith, Jr., 1941 New York Drive, Altadena.

## Direct Examination

By Mr. Gardner:

Q. Mr. Smith, you are the son of Horace O. Smith, Sr., are you not?           A. Right.

Q. And at the date of your father's death, how old were you, sir?           A. About 17.

Q. Did you know Mr. Colyear?

A. Yes, sir.

Q. Did you know him at that time? [396]

A. Yes.

Q. How long had you known Mr. Colyear in 1928 when your father died?

A. The Colyears had been close family friends to my mother and father.

Q. Well, Mr. Colyear took over the management of the Schalk Chemical Company. You have been sitting in the courtroom all this time, have you not, Mr. Smith, and you have heard that testimony from various sources?           A. Yes.

Q. Did you have any discussions with Mr. Colyear during say 1931 relative to your taking a position with the company?

A. Not in 1931, I was still going to school.



(Testimony of Horace O. Smith, Jr.)

Q. I see. When did you first have a talk with Mr. Colyear regarding employment in Schalk Chemical Company?

A. It must have been about somewhere around 1933 or 1934; I am not exactly sure on that, however.

Q. 1933 or 1934? A. I would say 1933.

Q. Now, did you eventually gain employment with Schalk? A. Yes, I did.

Q. Mr. Colyear hire you? A. Yes, he did.

Q. And what was your position when you were first [397] hired, and what year was it, sir?

A. In March, 1936, and I was a salesman.

Q. Would you state whether or not there was any reason you were not employed in 1933 or 1934 when you first discussed the matter with Mr. Colyear?

A. Well, I was completing my high school and Mr. Colyear felt I was too young immediately thereafter, and was not disposed to hire me at that time.

Q. Did you know whether or not Mr. Colyear had other business enterprises that he was running, managing? A. Yes.

Q. What other business enterprise did he have?

A. He owned and operated the Colyear Motor Sales, and I believe he owned also the Colyear Furniture Company at that time.

Q. Do you know of Mr. Colyear's general reputation as a businessman?

Mr. Hall: Did he know it at that time, is that your question?

Mr. Gardner: Yes, at that time.

The Witness: Yes, I knew of it.

(Testimony of Horace O. Smith, Jr.)

Q. (By Mr. Gardner): What was his reputation?

A. He was considered to be, I presume, at that time considered to be a successful [398] businessman.

Q. And you were hired then in March of 1936, as a salesman, sir?           A. Yes.

Q. How long did you remain a salesman with Schalk Chemical Company?

A. For several years, 1942 I was elected president, but even during that time I had done sales work in the field, that is by traveling with the other men in the various territories, and I still maintained a small territory of my own which I covered for the reason that I felt I could best appreciate the positions and the problems of the men in the field by so doing.

Q. Would you state, if you know, whether or not Mr. Colyear was grooming you to take over the position as president of Schalk Company, sir?

A. I believe he was.

Q. Now, who was the manager of Schalk in 1936 when you were first employed, that is, manager of the Los Angeles plant?           A. Mr. H. C. Lieben.

Q. How old was Mr. Lieben at that time, approximately, sir, if you know?           A. In 1936?

Q. Yes.

A. He is 65 now, so he couldn't have been over about 37 years.

Q. And how long had he been with the company, sir, if you know, in 1936?

(Testimony of Horace O. Smith, Jr.)

A. He had been with the company several years prior to that.

Q. Were you ever present when Mr. Lieben and Mr. Colyear discussed the business affairs of Schalk Chemical Company?      A. Yes, I was.

Q. And did they have many discussions during the period from 1936 to 1942, sir?

A. I presume so. However, a good deal of the time I was out on the road so I wasn't in the office at all times.

Q. In other words, you mean they had discussions at which you were not present?      A. Yes.

Q. But speaking of the discussions, were you present with Mr. Lieben and Mr. Colyear, did you have numerous discussions such as those?

A. Quite a few, I would say.

Q. What was Mr. Colyear's opinion of Mr. Lieben, if you know, sir?

Mr. Hall: I object, your Honor, on the ground it is hearsay evidence. Same problem as Mr. Gardner raised with regard to Colonel Dillon. I don't have the opportunity to test [400] the credibility of the opinion.

The Court: Sustained.

Q. (By Mr. Gardner): Did Mr. Lieben remain manager from, on up until 1942, sir, do you know?

A. Yes, he did.

Q. And he worked directly under Mr. Colyear, is that correct, sir?      A. Yes.

Q. Do you know Mr. Fulmer of the Chicago office?      A. Yes, very well.

(Testimony of Horace O. Smith, Jr.)

Q. When did you first meet Mr. Fulmer, sir?

A. I had met Mr. Fulmer many years ago when I was a small youngster, through my father.

Q. Now, after you became associated with the business, 1936, when did you next meet Mr. Fulmer?

A. I believe it was the spring of 1937.

Q. And what was his position at that time, if you know?

A. General sales manager.

Q. General sales manager, out of the Chicago office, sir?

A. Yes.

Q. Who was in charge of that plant, if you know?

A. Mr. Fulmer.

Q. Mr. Fulmer was, and Mr. Fulmer worked directly [401] under Mr. Colyear also, is that correct, sir?

A. That is correct.

Q. Now, how long had Mr. Fulmer been in charge of the Chicago office, that is, we are speaking now as of 1936 or 1937?

A. Oh, I would say at least ten years.

Q. In other words, he had been in charge of that office under your father, hadn't he?

A. Yes.

Q. Now, we go on up to 1942. Could you state whether or not of your own knowledge Mr. Farman attempted to gain employment with Schalk Chemical Company during any of the years 1936 to 1942, sir?

Mr. Hall: I object on the ground the question is too broad, it isn't pinpointed at any specific date. If Mr. Gardner knows when this occurred, he can pinpoint it. I don't think it is fair to ask the question over a five-year span, and it should be first pin-

(Testimony of Horace O. Smith, Jr.)

pointed as to who was present, where it was, and other material data.

The Court: The question is not improper. The witness may answer.

Mr. Gardner: Would you like the question read?

The Witness: Yes.

(The record was read.)

The Witness: I believe at one time Mr. Farman attempted to get a position with the Schalk Chemical Company. [402]

Q. (By Mr. Gardner): When was this?

A. I could not tell you the definite date.

Q. Could you tell me whether or not it was before 1940?

A. I believe it was.

Q. And do you know the result of his attempt to gain employment, sir?

A. He was not successful in gaining employment at that time.

Q. Whose decision was this?

A. I believe it was Mr. Colyear's. I am not positive, however.

Q. All right, sir, now going on to the time when you took over as president and supervisor, what year was that that you took over as president?

A. 1942.

Q. Was Mr. Colyear still alive then, sir?

A. Yes, he was.

Q. Was he ill at that time?

A. Not at that time, no.

Q. Not at that time. Did you have any discussions with Mr. Colyear as to whether or not you were ready to take over the presidency of this or-

(Testimony of Horace O. Smith, Jr.)

ganization?           A. Yes. [403]

Q. Mr. Colyear felt that you were ready?

A. Evidently.

Q. Now, when you first took over of course I suppose you worked closely with Mr. Colyear, did you not?

A. No, not too closely with Mr. Colyear, but I did work closely with Mr. Lieben and Mr. Fulmer.

Q. Now, if you had any major decisions or anything, I suppose you would naturally take that up with Mr. Colyear, then, wouldn't you?

A. Right.

Q. What about Mr. Fulmer, did you have any discussions with Mr. Fulmer in 1942 and prior to Mr. Colyear's death?           A. Yes; yes, I did.

Q. And was it your intention to leave Mr. Fulmer on as manager?           A. Yes.

Q. Was that Mr. Colyear's intention?

A. I believe it was.

Q. After Mr. Colyear died, I believe that was in 1943, was it not?

A. 1943 or 1944, I am not certain.

Q. In any event, after his death did you become the supervisor under the trust?           A. Yes, I did.

Q. And as supervisor under the trust, would you state [404] whether or not it was your intention to continue the business policies of Mr. Colyear in relation to the Schalk Chemical Company?

A. To a certain extent, Mr. Gardner.

Q. And in what extent did you intend to deviate?

A. In view of the situation, I was probably a

(Testimony of Horace O. Smith, Jr.)

little closer and more interested in the Schalk Chemical Company, and it was my livelihood and I was more interested in seeing it progress and grow.

Q. In other words, you were going to devote full time to this one enterprise, were you not?

A. That is correct.

Q. Now, during these years following the time when you were appointed supervisor, and on up to the time that you resigned, which was in 1948, January 15, 1948, was it? A. Yes.

Q. Up to that date, sir, did you attempt to develop new products? A. Yes, we did.

Q. Now, you have heard Mr. Farman testify that he provided you, or the Schalk Chemical Company, with numerous items to be developed and put on the market by Schalk. Would you state, sir, what was your practice when receiving a suggestion from Mr. Farman relative to a new product?

A. The general procedure was always to take a [405] suggestion of a new product that it was feasible to market by the company and submit it to the various salesmen in the field for their comments; being a small organization as we were, we were not in a position to hire a market analyst which are used widely by the large corporations today.

Q. Now, was that your practice when these suggestions that Mr.—

A. That was our general practice. Of course, many times people would suggest new products that we in the business would know instinctively why it

(Testimony of Horace O. Smith, Jr.)

would not be feasible to market such a product at that time.

Q. Now, did you discuss these products with Mr. Lieben?

A. Yes, I believe I did; I am certain of that.

Q. You would also seek his advice, wouldn't you?

A. Yes.

Q. You would seek the assistance of your salesmen in determining whether or not a product would move, wouldn't you?      A. Right.

Q. Now, at the time you became supervisor in 1943 we were in the midst of a war, were we not?

A. That is right.

Q. Were you having difficulty obtaining materials?      A. Yes.

Q. Were you having any trouble whatsoever moving your [406] products?      A. No.

Q. In other words, I take it you could sell just about anything that you could get hold of at that time, couldn't you, sir?

A. That seemed to be apparent.

Q. Did you have a labor problem?

A. Yes, we did.

Q. What was your labor problem?

A. We were, as all other concerns, were under the regulations of the War Manpower Act, I believe that is what it was called, and being in a non-essential business we were not in a position to hire new people, new laborers, factory help and so forth, without a priority.



(Testimony of Horace O. Smith, Jr.)

Q. This created quite a labor shortage in your organization, the Schalk Company, didn't it?

A. Yes, it did.

Q. So not only were you short of materials, even had you obtained more materials you wouldn't have been able to dispense or put the product out because of the labor shortage, is that correct, sir?

A. Pretty much so, I believe.

Q. Now, would you state, sir, when the first friction arose over your actions as supervisor?

A. I really don't know, Mr. Gardner; it appeared from [407] the beginning that my family did not want me to be supervisor of the trust and thereby vote stock and be president of the corporation.

Q. Was this feeling apparent even prior to the time you became president of Schalk?

A. I believe so.

Q. Do you know whether or not of your own knowledge there was an apparent animosity by the other stockholders toward Mr. Colyear?

A. Yes, very definitely.

Q. And how long had that existed, of your own knowledge?

A. For quite some years after 1931.

Q. In fact, the entire history of the management of Schalk from the inception of the trust was one of dissension, wasn't it?

Mr. Hall: I object to that as a leading question. Stating something that is not in evidence.

Mr. Gardner: Very good objection.

(Testimony of Horace O. Smith, Jr.)

Q. (By Mr. Gardner): But in any event, when you became the supervisor in 1943, there was dissension as between you and the other members of the family, the other stockholders? A. Yes.

Q. Now, who was the spokesman for the family?

A. I think Mr. Farman was, it was generally conceded [408] he was.

Mr. Hall: I didn't hear that answer.

The Witness: I say I think Mr. Farman was, it appeared that way.

Q. (By Mr. Gardner): Now, in 1945, I believe you have been in the courtroom and you heard Mr. Farman testify; in 1945 he came to the company and was hired as an expediter? A. Yes.

Q. Had he made any earlier efforts to obtain employment with Schalk Company while you were the supervisor or president?

A. I believe he did, I think the whole thing had built up to that point where in 1945 that the Chemical Company put Mr. Farman on.

Q. In other words, he had attempted to gain employment there prior to 1945?

A. Well, for a time there, he was employed by government agencies, and was not seeking employment at that time.

Q. I see. Did you talk over the possibility of hiring Mr. Farman with Mr. Lieben?

A. Yes, I did.

Q. What was Mr. Lieben's reaction?

Mr. Hall: May I object to the question if it is going [409] to the opinion of the witness; if it is

(Testimony of Horace O. Smith, Jr.)

asking did Mr. Lieben object or did he not object, I have no objection to the question, but I don't want him to state an opinion; Mr. Lieben is not here, it would be hearsay and I don't have the opportunity to cross-examine Mr. Lieben. The question is ambiguous to that extent. If the witness could answer and not state an opinion stated by Mr. Leiben.

The Court: Will you rephrase your question, Mr. Gardner?

Q. (By Mr. Gardner): Did Mr. Lieben object to the hiring of Mr. Farman by Schalk Chemical Company? A. Yes, he did.

Q. Did you discuss the possibility of hiring Mr. Farman with anyone else, sir?

A. With Mr. Fulmer.

Q. Mr. Fulmer? A. Yes.

Q. Did Mr. Fulmer object to the hiring of Mr. Farman?

A. I don't recall exactly whether he did or not, but it was left pretty much up to my decision, I believe.

Q. And your decision was to hire him?

A. Yes.

Q. Now, at that time, 1945, you were having difficulty getting materials, that is correct, isn't it, sir? A. Yes. [410]

Q. And you needed—whose idea was it to get an expediter to obtain these raw materials?

A. I believe it was Mrs. Farman's and Mr. Farman's idea.

Q. So you hired him on that basis, is that correct? A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. That was just about the only job available in the corporation at that time, wasn't it?

A. Yes.

Q. Now then, when was the executive committee set up?

A. You have the dates, Mr. Gardner, it must have been the latter part of 1955.

The Court: 1955 or 1945?

The Witness: 1945, pardon me.

Mr. Hall: It was in September, 1945, Mr. Gardner. [411]

\* \* \*

Q. (By Mr. Gardner): Mr. Smith, just prior to the recess we were discussing the executive committee which was formed in 1945, I believe. Now, would you state to the Court just exactly your understanding of the functions of that committee?

Mr. Hall: I object, your Honor, on the ground that it is not the best evidence. The powers and the purpose and the legal rights incident to the executive committee are set forth in the resolution setting up the executive committee, and the powers of the executive committee are those set forth in those minutes and no other.

The Court: I will receive the witness' testimony, not necessarily as evidence of what the powers of the committee were, but I will receive it as evidence of what he conceived them to be.

Mr. Gardner: Would you read the [413] question?

(The record was read.)

(Testimony of Horace O. Smith, Jr.)

The Witness: The executive committee was set up to handle management affairs of the corporation, and came about by reason of the fact that there was internal strife in the organization. We attempted to meet on a ground on which we could work harmoniously. As to the functions of the committee, I think the minutes state, the resolutions setting up that committee show the functions of that committee.

Q. (By Mr. Gardner): Might I request, Mr. Smith, that you speak a little louder?

Now, the executive committee as such was comprised of whom?

A. Mr. Farman, Mrs. Farman and myself.

Q. As supervisor you could have ruled against this, the formation of this executive committee, could you not, sir?

A. Yes.

Q. Were you attempting at this time to work out a peaceable settlement?

A. Yes.

Q. That was the intent of all parties, wasn't it?

A. Yes.

Q. Now, did the executive committee as such hold meetings in 1945?

A. I believe they did. [414]

Q. I show you Exhibit No. 32 which purports to be minutes of executive committee meetings. I ask you to examine that exhibit and state whether or not you have ever seen those minutes. [415]

\* \* \*

The Witness: Frankly, I don't recall ever seeing these, this memoranda before.

(Testimony of Horace O. Smith, Jr.)

Q. (By Mr. Gardner): Can you state whether or not you ever recall in any meeting listening to Mr. Farman read the minutes of the prior meeting?

A. I do not.

The Court: Were you present at these meetings?

The Witness: Yes.

The Court: I notice that at the end of some of them and possibly at the end of all of them there is a, those in handwritten form, in any event, there appears the word "Approved" and then three lines underneath that word "Approved." Apparently space for three signatures, and two of those lines have signatures, one of them, G. I. Farman and the other H. I. Farman and the third line is blank. Were these ever submitted to you for your signature?

The Witness: Not to my knowledge.

The Court: Proceed. [416]

Q. (By Mr. Gardner): Now, Mr. Smith, let's go on to the eventual dissolution of the executive committee. Would you state just briefly what events led up to the dissolution of that committee?

A. I believe that came about because of lack of harmony in management in the executive committee. I felt that it was serving no purpose as far as the corporation was concerned.

Q. Was there an effort on the part of the other stockholders to introduce new products, sir?

A. Yes.

Q. And these are the products that you have tes-

(Testimony of Horace O. Smith, Jr.)

tified you attempted to test by sending to your salesmen?      A. Some we did, yes.

Q. Some you did. Now, I believe you testified that in 1946 you were short of materials and short of labor?      A. That is right.

Q. In other words, this was not, or was this an opportune time to attempt to develop new products?

A. It might have been the time to attempt to develop new products, but it was surely not the time to market new products.

Q. In fact, in 1946 you were having all you could do to supply your already existing demands, is that correct?      A. That is correct. [417]

Q. Now, would you state whether or not you attempted to develop new products other than those suggested by Mr. Farman during the year 1946?

A. Frankly, I don't recall, but I doubt if we would have at that time. We had put on two new products just prior to the war, we were attempting to market those to the best of our ability.

Q. You were also attempting to get caught up with the demand?      A. With the demand.

Q. From the customers that you already had?

A. That is correct.

Q. Now, then, going to the agreement of January 15, 1948, would you state when the first discussion resulting in that agreement occurred?

A. It was no doubt in the early part of 1947, May or June, I would say.

Q. When, sir?      A. May or June.

Q. Of 1946 or 1947, sir?

(Testimony of Horace O. Smith, Jr.)

A. Of 1947, I believe.

Q. Of 1947. Now, was there a lawsuit brought about April of 1947?      A. Yes.

Q. And you know when the first discussion relative to [418] that particular action took place as between you and the other stockholders?

A. As I recall, no one discussed it with me prior to the time I was served with the summons or papers in regard to that lawsuit.

Q. Now, when did the executive committee dissolve?      A. Early in the spring of 1947.

Q. 1947 or 1946?

A. 1947, I believe, it must have been around March.

Q. Now, would you state whether or not the executive committee in your opinion ever worked smoothly?

A. I did not feel that it did; consequently, we dissolved it.

Mr. Hall: Who do you mean by we, Mr. Smith?

The Witness: The Board of Directors of Schalk Chemical Company.

Q. (By Mr. Gardner): Now, during 1946 did you have any discussions with Mr. Farman or with the other members of the family, the other stockholders, regarding either the purchase of their stock or the sale of your stock?      A. Yes.

Q. In this company?      A. Yes.

Q. When did this first discussion take [419] place?

A. As I recall there were numerous discussions



(Testimony of Horace O. Smith, Jr.)

along that line. I could not tell you the exact dates that those discussions took place, but there were various proposals made, various discussions, the purpose of which was to eliminate the strife and disharmony in the corporation, in the management.

Q. Did you ever suggest to the other members of the family that you purchase or acquire their stock, their beneficial interest in the stock?

A. No, I suggested to my mother that she sell the corporation at one time.

Q. This was in 1946, is that correct, sir?

A. I would seem to think that it was in 1946.

Q. At that time did you have any idea as to what the corporation might bring if sold?

A. I felt that it could be sold for close to a half million dollars.

Q. At that time?

The Court: What do you mean by selling the corporation? Are you referring to a sale of all of the stock of the corporation?

The Witness: All of the stock of the corporation, yes, sir.

Q. (By Mr. Gardner): And what did your mother say to your suggestion?

A. They were not interested in selling the corporation. [420]

Q. Did you suggest to her that she purchase your stock?           A. Yes.

Q. And it was at this time that you entered into the negotiations which finally resulted in the agreement of January 15, 1948, is that correct, sir?

(Testimony of Horace O. Smith, Jr.)

A. That agreement came about after the lawsuit in the spring of 1947.

Q. I see. In other words, you had discussions even prior to the lawsuit as to the possibility of selling either your stock or acquiring hers?

A. Yes.

Q. Did you ever talk to her, that is, Mrs. G. I. Farman, about acquiring her stock?

A. I don't believe I did for the reason I was not in a position to offer what I thought it was worth.

Q. What did you think the stock was worth in 1946, sir?

A. Well, as I stated before, I felt that the corporation could be sold for somewhere around a half million dollars. At that time businesses were being sold on as much as thirteen times the net profit, and our record of profits the past years indicated a good earning power of the corporation.

Q. The name Schalk was well known throughout the United States at that time, too, wasn't it?

A. Yes, it was.

Q. Would you say it had a valuable [421] goodwill?

A. Very much so, even though we showed the goodwill and formulas as only \$1.00 on our balance sheet.

Q. You didn't set any price other than \$1.00 on your balance sheet?      A. That is right.

Q. But you did give consideration to that in determining the value of the corporation and the value of the stock?      A. Very definitely.

(Testimony of Horace O. Smith, Jr.)

Q. Now, after the lawsuit in April of 1947, did you have any discussions with the other members of the family, the other stockholders, regarding the sale of your beneficial interest of the stock of the Schalk Chemical Company?      A. Yes, I did.

Q. When did the first discussion take place after the trial?

A. I don't recall the exact date, Mr. Gardner.

Q. Well, do you recall who was present?

A. I discussed the possibility of an agreement such as the one we entered into many times with Mr. Stanley W. Guthrie, together with Mrs. Farman and I believe Mr. Farman and my two sisters.

Q. Who was going to purchase your beneficial interest in the stock of the Schalk Chemical Company?      A. My mother and two sisters. [422]

Q. Was there any mention made of the corporation purchasing your beneficial interest in the stock of the Schalk Chemical Company?

A. Not as I recall.

Q. Was it your understanding that you were dealing with them on an individual basis?

A. Yes. You see, I was not in a position to sell my stock interest or my beneficial interest in the trust, therefore, I was compelled to deal with the two other beneficial holders of the trust.

Q. And it was your understanding that you were dealing with them in their individual capacity, is that correct?      A. Yes.

Q. I believe you have already stated this, but would you state once again for the record, whether

(Testimony of Horace O. Smith, Jr.)

or not you had any discussions with Mr. Farman, Mrs. Farman, your two sisters, regarding the corporation purchasing your beneficial interest in the stock of Schalk Chemical Company?

A. Of the corporation purchasing it?

Q. Yes.

A. I honestly don't recall, Mr. Gardner.

Q. Was it your impression that at all times you were dealing with them as individuals?

A. That is right.

Q. Now, how did you receive the amount, I believe it [423] was, it has been testified to that it was \$25,000.00 that was paid you on January 15, 1948?

A. Yes, sir.

Q. How did you receive that money, sir?

A. In the form of a certified check, I believe.

Q. And who gave it to you?

A. Mr. Guthrie.

Q. Mr. Guthrie. Now, you understood this to be payment of certain moneys from whom?

A. From my mother, Mrs. Farman, and my two sisters.

Q. And how much were you to get from your mother?

A. It wasn't stipulated what her share of that was to be, as I recall.

Q. In other words, you were selling your beneficial interest in that stock?

A. In the trust.

Q. In the Schalk Chemical Company, to your mother and two sisters?

A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. Now, in 1950 was there an additional amount due you?      A. Yes.

Q. What was that amount, sir?

A. \$20,000.00.

Q. \$20,000.00; now, who did you look to for payment [424] of that \$20,000.00?

A. The same parties that paid me the \$25,000.00.

Q. Who was that, sir?

A. Mrs. Farman, my mother, and two sisters.

Q. Now, at the time that you made this original agreement, that is, back in January, January 15 of 1948, just exactly what were you selling for the \$45,000.00?

A. My beneficial interest or stock interest in the Schalk Chemical Company.

Q. Did you feel that the stock, that is, the shares of stock had a value of \$45,000.00, sir?

A. Yes.

Q. Now, you were also giving up a position, weren't you?      A. Yes.

Q. How much was that position paying you at that time, sir?

A. \$6000.00 a year, I believe.

Q. Was it your understanding that you were to receive any amount for the loss of the \$6000.00 that you would subsequently incur?

Mr. Hall: Pardon me, I didn't get the question.

Mr. Gardner: Let me rephrase it, anyway.

Q. (By Mr. Gardner): Was it your understanding that any portion of the [425] \$45,000.00 that you were to receive under the agreement of

(Testimony of Horace O. Smith, Jr.)

January 15, 1948, was to reimburse you for the loss of your position and \$6000.00 a year for the next three years?      A. No, it was not.

Q. Did you feel that you could get another job just about as good as the one you were leaving, sir?

A. No, I was rather doubtful about that.

Q. Did you feel that you could get a job paying substantially the same, sir?      A. Yes. [426]

\* \* \*

Mr. Hall: Your Honor, may I request the privilege of calling Mr. Olson at this time, because Mr. Olson is engaged in commitments later today, and I would like to present his direct examination at this time.

Mr. Gardner: No objection, your Honor.

The Court: You may do so.

Mr. Hall: Mr. Olson.

### MILO V. OLSON

a witness called by and in behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Would you state your name and address for the record?

The Witness: Milo V. Olson. 1409 Hillcrest Avenue, Pasadena.

The Clerk: o-n, or e-n?

The Witness: o-n.

(Testimony of Milo V. Olson.)

Direct Examination

By Mr. Hall:

Q. Mr. Olson, are you an attorney at law?

A. Yes, sir.

Q. In 1947 and 1948, were you a partner of the law firm of Guthrie, Darling and Shattuck?

A. I became a partner, I think it was November 1, 1947. I worked there as an employee from January 1, '47, until November 1, '47. [430]

Q. Are you acquainted with the action filed in 1947 in the Superior Court of the State of California, for the County of Los Angeles entitled Evelyn Smith Marlow and Patricia Farman Smith—or, excuse me—Patricia Farman Baker, versus Union Bank and Trust Company, Horace O. Smith, Jr., and other parties?

A. I am familiar with that action.

Q. Did you participate with Mr. Stanley W. Guthrie in the preparation of the complaint filed in that action?

A. Yes, with Mr. Guthrie and with other members of the firm.

Q. Did you handle the demurrers which were filed to that complaint?

A. I argued the demurrer.

Q. May I have Petitioner's Exhibit 16?

Mr. Olson, I hand you Petitioner's Exhibit No. 16, and I ask you if you are familiar with that document?

(Testimony of Milo V. Olson.)

A. You have to pardon me. What I thought was a copy of it appears to be a copy, but it is not a ribbon copy. So, I will have to check.

What I have in mind is this copy, obviously not made at the same time. This is an exact copy of what I have here, in my file, and I am certainly familiar with this Exhibit No. 16.

Q. Did you participate in the negotiations leading [431] to that agreement? A. Yes, I did.

Q. Who did you deal with in those negotiations?

A. Well, in my own firm, I dealt, of course, with Mr. Guthrie, and on the other side, why, it was Mr. Wackerbarth, the attorney for Mr. Smith.

Q. Do you know Mr. Smith? A. Oh, yes.

Q. Did you deal with Mr. Smith?

A. Well, we had litigation going on; we dealt to this extent that Mr. Smith was the opposing party and his attorney was Mr. Wackerbarth, as I recall. To that extent, we dealt with Mr. Smith, but only through Mr. Wackerbarth. I think Mr. Smith was present at certain of our conferences certainly.

Q. May I have Petitioner's Exhibit 15? It is a letter.

Mr. Olson, I hand you Petitioner's Exhibit 15; do you recall that document?

A. I notice this document is dated September 20, 1945.

Q. I am sorry.

A. And I undoubtedly have seen it, but that is



(Testimony of Milo V. Olson.)

not one of the documents I reviewed last evening in getting ready for my testimony today. [432]

Q. I made a mistake. I had the wrong exhibit number. It is a letter dated—

A. To answer your question, I am undoubtedly familiar with it, but I haven't reviewed it recently.

Q. A letter dated September, '47.

A. September 12, '47. Is that the letter you have reference to?

Mr. Hall: Excuse me, Exhibit No. 22, your Honor.

Q. (By Mr. Hall): Mr. Olson, I hand you Petitioner's Exhibit No. 22, do you recall that letter?

A. Yes. I reviewed a copy of this letter which I have in my file here, my old file. So I do recall that document, Exhibit 22.

Q. That bears what date?

A. September 12, 1947.

Q. Prior to that date, did you submit any settlement proposals to Mr. Smith or Mr. Wackerbarth?

A. I have here the answer to your question is yes.

Q. What proposal did you submit?

A. I submitted—I have to take it out, 69 file, a copy. I don't believe an original, but a copy of the memorandum which was prepared in somewhat rough draft for me, which I have here.

I think this was undoubtedly handed either by me [433] or Mr. Guthrie to Mr. Wackerbarth prior

(Testimony of Milo V. Olson.)

to September 12, 1947. This document I have right here.

Q. Have you reviewed that document?

A. Yes. I looked it over last night.

Q. What is the proposal contained in that document?

A. Well, the proposal contained in the document, basically, was that Schalk Chemical Company would procure, or be successful in procuring the resignation of Mr. Smith, as a supervisor, and pay him the sum of \$25,000, and it was suggested that that be paid over the period of five years, and that Mr. Smith would render some consulting services during the five years, as consideration, apparent consideration for the \$25,000.

Frankly, the \$25,000 was being paid to Mr. Smith and was suggested to be paid to him so he would resign as supervisor or manager of the Schalk Chemical Company, and the other part of the proposal which is here in writing, speaks for itself, but the other part of it was that there would be an option given to Schalk Chemical Company to buy Mr. Smith's stock, and I have in mind, as I recall at that time, there was a problem because I believe his stock was in trust in some way. I would have to review that.

But my recollection was that there would be an option to buy his stock for additional sum of \$20,000.

I believe that is what this thing says. [434]

(Testimony of Milo V. Olson.)

Q. And that proposal was submitted to whom, Mr. Olson?

A. It was submitted to, undoubtedly, and I say undoubtedly because that is the way we handle it, to Mr. Wackerbarth on behalf of Mr. Smith. It was submitted by Mr. Guthrie and me on behalf of our clients.

We were purporting to represent the Farman family group to get the Schalk Chemical Company in control, you might say, of Mr. Farman, and to eliminate Mr. Smith as supervisor, and this was the proposal that was submitted in that regard.

Q. Was there any proposal to pay him the \$25,000 in a lump sum?

A. I think that was also considered.

Q. That was to be paid by whom?

A. That was to be paid by, as I recall now, that was to be paid by Schalk Chemical Company, and we were going to work it out by having the individuals make a loan to the Schalk Chemical Company so it would have the loan to pay Mr. Smith \$25,000. My notes indicate that.

The Clerk: Petitioner's Exhibit 37 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 37 for identification.) [435]

Q. (By Mr. Hall): Mr. Olson, I hand you a document marked Petitioner's Exhibit 37 for identification. Is that the memorandum to which you referred?

(Testimony of Milo V. Olson.)

A. That is the memorandum which I referred to, as the proposal that was submitted to Mr. Wackerbarth as attorney for Mr. Smith.

I don't say—that document was a copy of that document, obviously, Mr. Hall.

Mr. Hall: I offer this document as Petitioner's Exhibit 37.

Mr. Gardner: May I ask a few questions on voir dire, your Honor?

#### Voir Dire Examination

By Mr. Gardner:

Q. I note that this document bears no date, sir. Could you tell me what date this document was prepared?

A. The fact that it was before, undoubtedly before we received back the letter dated September 12, 1947, I couldn't tell you whether it was in September or whether it was in August, but it was during the year 1947, because I didn't, I didn't start working on this matter till after January 1.

Pardon me. I wrote one memoranda in my old office in 1946, but I didn't start working actively on this matter until after the lawsuit was filed, with regard to any [436] settlement. The lawsuit——

Q. Till after the lawsuit?

A. Till after the lawsuit was filed.

Q. I see.

A. So, it would be between the time the lawsuit was filed and September 12, 1947.

(Testimony of Milo V. Olson.)

Q. That would be between April 28 of 1947?

A. If that is the date the complaint was filed, yes.

Q. Well, I am not too positive about that. It was in April, April 14 or 28, I believe, sometime between that date and September.

A. My guess would be it would be later than that. It would probably be after the demurrer had been sustained, to the original complaint. That is when we really got down to negotiating on this matter, other phase of the matter, rather than litigating any further.

Q. I notice, sir, this is in rather rough form.

A. That is what I testified.

Q. Yes, of course. Did you present a copy of this to Mr. Wackerbarth for his keeping?

A. Yes. That I never want to say positive, because every time I do, I am quite sure undoubtedly that is the case, because that was the purpose of preparing the memorandum.

Q. Did the copy that you gave to Mr. Wackerbarth contain these same deletions? [437]

A. That I don't doubt. I don't know. That might have occurred during a conference with Mr. Wackerbarth. I don't know.

Q. In any event, this was a preliminary step, as I take it, in your negotiations?

A. This was our proposal, one proposal. I had other proposals in mind that I suggested to Mr. Guthrie. This was the proposal we finally submitted to Mr. Wackerbarth.

(Testimony of Milo V. Olson.)

Q. I see.

A. I don't say finally. It is the one we submitted to him.

Q. It is one of the proposals?

A. That is right.

Q. That is, that you submitted to him?

A. That is right.

Mr. Gardner: I have no objection to this document.

The Court: Admitted.

(The document heretofore marked for identification Petitioner's Exhibit No. 37 was received in evidence.)

The Clerk: Exhibit 37.

The Court: Did you say that the demurrers were sustained?

The Witness: With leave to amend, so that is while we are waiting to prepare the amended complaint, that the [438] negotiations got underway. As I recall, we got extensions of time on that leave.

### Direct Examination

(Continued)

By Mr. Hall:

Q. Were any other settlement proposals made to Mr. Smith, or Mr. Wackerbarth?

A. Well, I don't know how to answer that. I do know we got a counter proposal from Mr. Wackerbarth on behalf of Mr. Smith, and which is your Exhibit 22 here in evidence.

(Testimony of Milo V. Olson.)

And then there were further negotiations that ensued and the result was this agreement which you showed me, Exhibit 16.

Q. Well, Mr. Olson, did Mr. Smith and Mr. Wackerbarth refuse all proposals that the corporation pay Mr. Smith and take an option on his stock?      A. Yes.

Q. Was it the intent and desire of the family at all times that the settlement be effected between the corporation and Mr. Smith?      A. That was.

Mr. Gardner: If the Court please——

The Witness: I assume he is objecting, so I will wait.

Mr. Gardner: May I object to, as to this witness testifying as to the intent of the family. He can state what the family told him, but I think that that would be [439] assuming something. It is a conclusion.

The Court: Sustained.

Q. (By Mr. Hall): Were the settlement proposals discussed with the family?

A. Many times.

Q. What member of the family were they discussed with, usually?

A. Well, usually with Mr. Farman, Mrs. Farman and I know I went out to their home in Sierra Madre and the whole family were there. I mean, the daughters and the sons-in-law were there.

Q. What did they state to you with regard to the manner in which they wished the settlement to be effected?

(Testimony of Milo V. Olson.)

A. I cannot give you exact conversation at this time. I can give you the substance of what our conversations were.

Q. Please do.

A. In substance, my instructions were to attempt to figure out a way where the Schalk Chemical Company could pay Mr. Smith in the manner in which was set forth in that exhibit, which just went into evidence—whatever number you put on that. That was the basic idea of—I call it my clients, or really Mr. Guthrie's clients.

And I mean it is expressed as well in there as I [440] could state it.

Q. You put in considerable study on this matter?

A. Yes, indeed I did.

Q. In your opinion, did the family, as opposed to Mr. Smith, have any choice as to the manner of making the settlement?

A. If you state settlement, Mr. Smith would only settle on the basis which was set forth in the agreement that was finally executed as was contained in the memoranda or letter of September 12, 1947.

As I understand, the settlement, your choice is what the other party is willing, finally willing to do. I don't know how to answer. The family could have continued to litigate. They did have that choice, but we choose to settle.

Mr. Hall: You may examine.



(Testimony of Milo V. Olson.)

Cross-Examination

By Mr. Gardner:

Q. Mr. Olson, I believe you testified that you represented the members of the family, the stockholders, other than Horace Smith?

A. Oh, I don't know how to answer. We represented the Plaintiff in the case, but we were basically representing Mr. and Mrs. Farman, and those members of the family that were sympathetic to the— Mrs. and Mr. Farman, if that answers your question, that those are the people we were [441] representing.

Q. Did they seek your advice in representing them?      A. Often.

Q. And did you make a study of the best way, that is the most advantageous way to them, personally, and to the corporation?

A. My study——

Q. To——      A. Pardon me, excuse me.

Q. To obtain the stock of Horace Smith, Jr., as well as control of the corporation in 1947?

A. The answer is yes.

Q. And did you advise them of the results of your study, sir?

A. I will answer you this way: I gave the memoranda giving my opinions to Mr. Guthrie and then Mr. Guthrie in my presence would advise them, so it was actually Mr. Guthrie who was speaking, and I was sitting there, participating to this point where I would answer, yes, sir.

(Testimony of Milo V. Olson.)

Q. And this proposal that we have here, that was the result of your advice to the stockholders; wasn't it?

A. You are speaking now of which exhibit, please?

Q. The proposal Exhibit No. 37, sir.

A. Yes. That is a result of one part of my advice. I have another memoranda here, if you are interested in where [442] I had another idea on the matter.

Q. The point is that you advised them that this was the thing to do?

A. Yes, or we wouldn't have submitted it.

Q. Now, did you, sir, continue to represent Mrs. Farman and the two daughters after the agreement of January, was it 15, 1948?

A. I think I have handled the final negotiations where we received court orders to put the settlement into effect. I attended the stockholders meeting, I think, where Mr. Farman was elected president.

I handled the negotiations on getting the stock certificates that were issued, and after that phase of it was completed for all practical purposes, that is the end of my participation.

Q. I see. A. In the matter.

Q. Now, I believe you, as you state in this document, the intent is to have the—that it is your intent in that document, was to have the Schalk Chemical Company take over this obligation; is that correct, sir? A. That is right.

(Testimony of Milo V. Olson.)

Q. Could you tell me why, sir, that you did not take steps to have the corporation assume that obligation immediately on January 15, 1948? [443]

A. For the reason that I no longer handled the corporate—I am supposed to be the trial attorney in that office, and I got out of the corporate end of it as quickly as I could, so I had nothing to do with what the Schalk Chemical Company did legalwise, or any other way after this settlement agreement was executed. I got out of the picture and gave no further advice.

Mr. Darling and Mr. Guthrie were the gentlemen who handled the corporate phases of our office.

Q. So you don't know why the corporation did not take steps to assume that obligation at that time, do you?

A. I do not know.

\* \* \*

Mr. Gardner: Mr. Smith, please.

HORACE O. SMITH, JR.

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

The Court: Proceed.

Cross-Examination

By Mr. Hall:

Q. Mr. Smith, I believe you testified that you were employed in 1936 by Schalk Chemical Company as a salesman; is that correct?

A. That is correct.

(Testimony of Horace O. Smith, Jr.)

Q. How long did you remain in the position of salesman with Schalk Chemical Company?

A. Even after the time that I was made president in 1942, I still had a small territory in which I serviced, and——

Q. Up to the time of your—that you were elected president, did you devote all your time to being a salesman?

A. A good percentage of the time, yes.

Q. Now, when were you elected a director of Schalk Chemical Company?

A. That I don't recall, the date. The minutes will show that.

Q. Yes. And you were also subsequently elected a vice president; is that correct?

A. That is correct.

Q. And during the time that you held those offices, up until 1942, you devoted most of your time to selling activities; is that correct?

A. Yes. I would say that was correct for the simple reason our organization was built around, it is a sales organization primarily. [445]

Q. Now, prior to working for Schalk, did you have any business experience? A. No.

Q. Now, how old was Mr. Colyear in 1942, Mr. Smith, do you know?

A. No, I don't know. He was——

Q. What would you estimate?

A. He must have been in his early 60's.

Q. Was he related to your family in any way?

A. No.

(Testimony of Horace O. Smith, Jr.)

Q. Was Mr. McGinnes related to your family in any way? A. No.

Q. Now, I believe you testified that there was animosity between the family and Mr. Colyear; is that correct? A. I believe there was, yes.

Q. And that was prior to what year?

A. It must have developed after he took over as president and supervisor of the trust.

Q. Do you know what the basis for the animosity was? A. Frankly, I don't know exactly.

Q. Did it have to do with the management of Schalk? A. Yes. [446]

Q. Was your mother opposed to Mr. Colyear?

A. Not at first, but she was later.

Q. Well, by later, do you mean a year later?

A. It must have been a year later. I am not sure.

Q. In other words, the animosity as far as you know developed in 1931? A. It could have.

Q. Were there objections by any member of the family to the manner in which Mr. Colyear was managing the corporation?

A. At what time, Mr. Hall?

Q. Well, during the time that he was supervisor and trustee? A. Yes.

Q. And was that the commencement of his taking over? A. That I don't recall, frankly.

Q. What objections do you recall?

A. That is rather difficult to answer, Mr. Hall.

Q. You have no recollection?

A. Well, there were a number of objections. I

(Testimony of Horace O. Smith, Jr.)

think the main objection was that he held close control of the corporation.

Q. Did he permit the family any say in the business at all?

A. I don't believe he did. [447]

Q. Now, Mr. Smith, you took over as president in 1942. I believe you testified that when you took over you continued Mr. Colyear's policies; is that correct?

A. That is pretty correct, yes.

Q. I think you qualified that and said with some deviation?

A. Yes.

Q. Yes. Well, what deviations did you have in mind?

A. I think perhaps I was a little more interested in developing new products.

Q. You were closer to the company?

A. Closer to the company, I believe, than Mr. Colyear was for that reason.

Q. Well now, Mr. Smith, don't you think the family expected you to do something different than follow Mr. Colyear's policies?

A. Yes, I believe they did.

Q. But you continued his policies except that you were closer to the picture; is that correct?

A. That is correct.

Q. Now, I believe you testified that evidently Mr. Colyear was grooming you to be president; is that your testimony?

A. Yes.

Q. Well, you were named as supervisor in the trust, [448] were you not?

A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. And when you succeeded to the office of supervisor, you had full control?

A. That is correct.

Q. Was it necessary for anybody to groom you for the office that was your right, was it not?

A. Under the trust indenture that was my right, providing I was willing and able.

Q. Does it provide in the trust, in the declaration of the trust, that you can resign as supervisor of the trust?           A. I believe it does.

Q. Now, you testified that when you took over major decisions were discussed with Mr. Colyear. Now, you took over in 1942, Mr. Smith, at the time you took over, was Mr. Colyear in good health?

A. Fair health for a man of his age, I believe.

Q. He died short time later, did he not?

A. I think it was in '43 or '44. I am not sure.

Q. Do you know what he died of?

A. No. I believe it was a heart condition.

Q. Could it have been cancer?

A. That I don't know.

Q. Well now, you took over in September, 1942 as [449] president, as I recall.

A. Yes. But not as supervisor.

Q. Not as supervisor. What major decisions did you make in 1942 after you took over, that you discussed with Mr. Colyear?

A. Gee, I really cannot tell you that, because I don't recall.

Q. Do you have a recollection that there were any?

(Testimony of Horace O. Smith, Jr.)

A. There must have been some, and several.

Q. In what regard?

A. In general management of the business.

Q. Well, do you have any illustration of what you mean by general management of the business?

A. That was several years ago, Mr. Hall, and it would be rather difficult to testify.

Q. I appreciate that, Mr. Smith.

Where would you discuss these matters with Mr. Colyear?

A. Either at Mr. Colyear's office, or in Mr. Wackerbarth's office.

Q. Now, Mr. Smith, do you know of your own personal knowledge that Mr. Farman asked Mr. Colyear for a job at any time; that is, of your own personal knowledge?

A. No, I don't believe I can say that, as I was not [450] a witness to anything of that nature.

Q. I believe you testified yesterday that you thought that had occurred?

A. I was informed of that. Now, that is only hearsay.

Q. But you have no personal knowledge of that?

A. No.

Q. Do you have—strike that.

Now, from your observation, who did Mr. Colyear rely on to manage Schalk Chemical Company?

A. Prior to what time?

Q. Prior to the time you became president, Mr. Smith?

A. Mr. Lieben.



(Testimony of Horace O. Smith, Jr.)

Q. That was from 1930 to 1942. I will reframe that question, it is not a fair question.

From the time that Mr.—after Mr. Williams left—I am not sure when that was—but after Mr. Williams left, up to the time in 1942, did Mr. Colyear rely principally on Mr. Lieben to manage the business? A. Yes, yes.

Q. And subsequent to 1942, you also relied on Mr. Lieben, is that correct?

A. That is correct.

Q. Now, was Lieben actually general manager of Schalk Chemical Company prior to 1944? [451]

A. He acted as general manager; whether or not the board appointed him as general manager, I do not recall.

Q. Yes. Well, the minutes show that he was appointed general manager in 1944. You testified somewhat at length yesterday about Mr. Lieben and his management of the company.

Did you mean that Mr. Lieben was manager of the Los Angeles office?

A. Manager of the Los Angeles office, and since the Los Angeles office was the home office, where the general books, ledgers were kept, he was also in charge of those.

Q. But Mr. Fulmer was directly responsible to Mr. Colyear; is that correct?

A. And Mr. Lieben, I believe, to some extent, he was.

Q. You testified yesterday that Mr. Fulmer was directly responsible to Mr. Colyear?

(Testimony of Horace O. Smith, Jr.)

A. I think he was; I think he was.

Q. In other words, the eastern division of Schalk and the western division was managed separately, were they not?

A. As far as sales were concerned only.

Q. Well, most of the manufacturing was, or formulation and production was done in Chicago, was it not? [452]

A. Two-thirds, yes, approximately.

Q. Two-thirds?           A. Yes.

Q. Now, you relied on Mr. Lieben to advise you to a great extent, after you took over; is that correct?           A. That is correct.

Q. Now, were you and Mr. Lieben always in accord on whether proposals for products were good or bad?           A. No.

Q. Now, did Mr. Fulmer object to Mr. Lieben's appointment as general manager in 1944?

A. I do not know whether he was or not.

Q. Do you know if Mr. Lieben ever went to the Chicago office of Schalk Chemical?

A. Many times.

Q. And when was that?

A. I couldn't tell you the dates, Mr. Hall, but he was back there at least once a year.

Q. Was that up to the time that you took over?

A. No, prior to that, and also after the time I took over.

Q. Well, after the time that you assumed control, do you recall the occasion when he was back there in Chicago?

(Testimony of Horace O. Smith, Jr.)

A. He would be back there when we would have our annual sales meetings. [453]

Q. And were you there at the same time?

A. Yes.

Q. And was there any antagonism between Mr. Fulmer and Mr. Lieben at that time?

A. Not to my knowledge.

Q. When did you first become acquainted with Gerald I. Farman?

A. It must have been in 1928. I am not sure on the date, however, may have been prior to that.

Q. Do you recall when your sisters first designated Mr. Farman to be a director of Schalk?

A. No, I do not.

Q. Well, the minutes reflect, Mr. Smith, that it was in 1944. Was there some controversy going on at that time between the family and you?

A. Yes, there was.

Q. Now, as part of one attempt to overcome that dispute, was Mr. Farman elected a director?

A. Ultimately he was. I don't know the exact date that that took place. The minutes will show.

Q. Was it in connection with the attempt to settle the dispute that he was elected a director?

A. I believe it was, yes.

Q. Who did he replace as a director, Mr. Smith?

A. I don't recall, frankly. [454]

Q. Did he replace Mr. Lieben?

A. It is a possibility. I would have to look over the minutes to find out.

(Testimony of Horace O. Smith, Jr.)

Q. Yes. Was Mr. Farman also elected an officer of Schalk?      A. Yes.

Q. And what office did he hold?

A. I think he was elected as vice president.

Q. And he held that office in 1946; is that correct?      A. I believe so.

Q. What functions did Mr. Farman perform in the management of Schalk in 1945 and '46?

A. I believe the principal function was to expedite materials, raw materials and so forth.

Q. In other words, to **procure**?

A. Procure raw materials.

Q. Raw materials and supplies, that were short at that time?      A. Yes.

Q. You say the prime function; were there other functions?

A. Oh, there must have been other functions that he performed, yes.

Q. Well, did he do anything with regard to modernizing equipment? [455]

A. I believe it is my recollection that he ordered a piece of fully automatic equipment for the Chicago plant.

Q. Did he participate in the purchase of some semi-automatic equipment?

A. He might have.

Q. Did Mr. Farman have anything to do with changing the style of packaging of Schalk products, in that year?      A. Yes.

Q. What was done with regard to packaging of Schalk products in that year?

(Testimony of Horace O. Smith, Jr.)

A. I am not sure whether it was in 1946 or not, but we were all aware of the fact that modernization of the packages were desirable, and they were discussed in general sales meetings.

Q. Could you describe briefly what was done with regard to changing the packaging? Was it to make the color uniform or something along that line?

A. That was one of the objects to keep a common identity for all the Schalk products.

Q. Was that Mr. Farman's suggestion?

A. It may have been.

Q. Now, Mr. Lieben, I believe you said was antagonistic to Mr. Farman; is that correct?

A. I don't recall whether or not I worded it that way.

Q. Well, he objected to Mr. Farman coming with the [456] company, Mr. Lieben objected?

A. I believe he did.

Q. Did Mr. Lieben also object to your mother's participation in the business?

A. Not as I recall.

Q. Were there any discussions between your mother and Mr. Lieben about the management of the business?      A. Undoubtedly there were.

Q. And were you present, Mr. Smith, on some of the occasions?      A. Some of the occasions.

Q. And were those discussions friendly discussions between your mother and Mr. Lieben?

A. To my recollection they were.

(Testimony of Horace O. Smith, Jr.)

Q. Was your mother at any time opposed to Mr. Lieben?

A. I think she was opposed to Mr. Lieben from the very beginning.

Q. I see. Now, Mr. Lieben was displaced as a director when the executive committee was implemented; is that correct?

A. I am not sure. I would have to refresh my memory by looking at the minutes.

Q. Yes. Well, assume it to be true. Thereafter, did Mr. Lieben remain general manager of Schalk?

A. Yes. [457]

Q. Now, the executive committee was set up in September, 1945, so from that date until what date was Mr. Lieben a general manager of Schalk?

A. I could not tell you the exact date.

Q. Well, was he general manager up until the time that you resigned as supervisor and president of Schalk?

A. As I recall he was.

Q. And this, Mr. Smith, was notwithstanding the objections of Mr. and Mrs. Farman to his being general manager; is that correct?

A. That is correct.

Q. Now, with regard to products, during the years 1942 to 1946, what product development program did you have; by you, I mean did Schalk Chemical Company have under your control?

A. We were always seeking new products that were, would fit into the Schalk line and could be marketed by the Schalk Chemical Company.

(Testimony of Horace O. Smith, Jr.)

Q. Well, did you have any products that were being developed in those years?

A. What were the years now?

Q. 1942 to 1946.

A. '46. Well, we put, I believe, two products out during that period.

Q. Well, are you referring to plaster pencil? [458]

A. That is one, yes.

Q. Yes. Now, prior to 1946, was plaster pencil something that you were developing, Mr. Smith?

A. No, it was not.

Q. Who suggested plaster pencil?

A. I think Mr. Farman did.

Q. And the other one was spot remover, I believe; is that correct?

A. Correct.

Q. That was put out by Schalk, I believe, in 1947?

A. Yes.

Q. Prior to 1946, was that being developed by you or your management?

A. It had been discussed in various sales meetings prior to that time.

Q. By sales meetings prior to that time, do you mean a meeting at the Biltmore Hotel in November and December, 1945?

A. No. It had been discussed by meetings several years prior to that.

Q. Yes. What was done following those meetings with regard to that product?

A. Nothing was done to the product for one reason, was that the war was going at that time, and it was a little difficult to obtain new cans under

(Testimony of Horace O. Smith, Jr.)

Government allocation, [459] which would have been required for spot remover, and raw materials as well.

Q. I believe you testified yesterday that during the war period and including 1946, it was opportune to consider a development program?

A. That is correct.

Q. But you had none?           A. That is correct.

Q. And as I understand it, you were stisfied to promote the two products which I believe you say were added prior to the war, just prior to the war?

A. I did not say that I was satisfied. I said we were forced to be, we were forced to be content with the situation because lack of raw material.

Q. And those two products were crack filler, which Schalk put on the market in 1937, and wood putty which Schalk put on the market in 1940; is that correct?           A. That is correct.

The Court: Mr. Smith, I have before me the various minutes of the executive committee that were introduced as Exhibit 32, and the last sheet purports to refer to a meeting of the executive committee on July 31, 1946. The last paragraph of those, of that sheet states that Mr. Smith expressed his disfavor to adding a cement waterproof paint to the Schalk line, and voted against any further products [460] being added to the Schalk line until we complete the marketing of a paint and varnish remover, liquid Savabrush, spot remover, and P-Tile Cement.

Now, that suggests to me that they were then



(Testimony of Horace O. Smith, Jr.)

under consideration, the introduction of four new products, namely, paint and varnish remover, liquid Savabrush, and spot remover, and a tile cement.

Was there then in progress the development of those four new products, in July of 1946?

The Witness: There could have been. When you say progress, your Honor, the preparation of preparing labels and cans and formulations—

The Court: And on April 2, 1946, there appears to be minutes of a meeting which states that G. I. Farman presented a plan of purchase and—I am summarizing—a secret formula for a paint and varnish remover, a plan said to have been negotiated by Mr. Farman, and then at the end of these minutes, it is recorded that it was unanimously voted to purchase the formulas suggested.

Since you were a member of the executive committee, I take it you voted for the purchase of that formula?

The Witness: I don't recall it, your Honor; I could have.

The Court: Well, what I am trying to find out is [461] whether you, in fact, were not cooperating, that is, whether you were in fact cooperating in the development of these new products that did ultimately emerge?

The Witness: I have.

The Court: This would suggest to me that you were cooperating and if you were not, I would like to have your comments.

The Witness: I, as I testified earlier, your

(Testimony of Horace O. Smith, Jr.)

Honor, the whole purpose of the organization was to develop more products. We realized at that time, or at the time I became president, that the survival of our business was growth and it was necessary to develop more products.

Now, I have records that show that way back before the war the company was anticipating and attempting to develop a paint and varnish remover. These records are in the form of minutes of sales meetings, general sales meetings in Chicago.

The war came along and precluded that we get into that type of business at that time, simply because we could not get the necessary materials.

Mr. Hall: May I ask some questions about that, your Honor?

Q. (By Mr. Hall): Well, Mr. Smith, isn't it true that either towards the end of 1945 or in 1946, you agreed that Schalk [462] would put out a paint and varnish remover; did you agree to that?

A. I don't recall as I say.

Q. Were you in favor of it at some time?

A. Yes.

Q. Yes. Did you later say no, we are not going to put it out?

A. I don't recall, Mr. Hall.

Q. Is it possible that you said that?

A. It could have been possible.

Q. Now, liquid Savabrush, who suggested liquid Savabrush, do you recall?

A. I don't know.

Q. Could it have been Mrs. Farman?

A. It could have been.

(Testimony of Horace O. Smith, Jr.)

Q. Yes. Did you agree at one time that that product should be marketed by Schalk?

A. I don't recall.

Q. Well, in 1946, Mr. Smith, did Schalk have any liquid products?

A. None at all.

Q. Were you concerned with the problems of putting out liquid products?

A. I don't believe that I considered it as a major obstacle. [463]

Q. Well, did you agree at one time to put out liquid Savabrush?

A. That I don't remember.

Q. Could you have agreed?

A. I could have, yes.

Q. Yes. And thereafter, could you have refused to put it out in the years '46 and '47?

A. I don't recall. I could have.

Q. Now, Peter Putter Tile Cement. I believe that is Peter Putter.

A. Plaster pencil.

Q. Or plaster pencil.

A. Peter Putter's Tile Cement, yes.

Q. Peter Putter's Tile Cement that was eventually put on the market by Schalk Chemical Company, I believe; is that correct?

A. That is correct.

Q. And that was in 1948, after you resigned?

A. I don't know; I don't recall.

Q. But it was after you resigned; is that correct?

A. I believe that we had a tile cement before I resigned.

Q. Well, what tile cement was that, Mr. Smith?

(Testimony of Horace O. Smith, Jr.)

A. That was a dry type of material.

Q. Did you have a formula for that? [464]

A. What do you mean by a formula?

Q. Well, had you acquired a formula for that product?

A. No. At the time we were buying the ingredients ready mix from another concern, mix from another concern, I believe.

Q. Was the product put on the market by Schalk that was tile cement prior to 1948?

A. I am not sure, but I believe there was. I am not positive.

Q. Well, if I show you the price list in 1947, can you tell me?           A. Yes.

Mr. Hall: It is not the red one, it is the white one.

Q. (By Mr. Hall): Now, I show you, Mr. Smith, or I will hand to you, Mr. Smith, Petitioner's Exhibit 13, which is a price list dated November 1, 1947. Is there a tile cement on that?

A. No, there is not.

Q. Depicted on that list, there is not?

A. No.

Q. Would you assume from that, because of the date it bears, that there was no tile cement?

A. I would assume from that, yes.

Q. Yes. Now, is the tile cement product that Schalk eventually put out, the type of product that you were [465] describing?

A. Yes. I think the groundwork had been done

(Testimony of Horace O. Smith, Jr.)

on it, evidently, and it was not listed in this particular dealer price sheet.

Q. And at the end of 1947, did Schalk Chemical Company have—had it acquired the formula for that product, tile cement?

A. The formula was a material that was, as I recall, made by the Continental Chemical Company in Los Angeles.

Q. Yes. Now, had you acquired the formula from Continental Chemical Company?

A. No. We purchased the ready mix material, the package.

Q. Well did you put the product on the market in 1947?

A. I don't recall, Mr. Hall. I think the records should show that clearly.

Mr. Hall: Your Honor, may I have the Exhibit 33?

The Court: What is it?

Mr. Hall: It is the notes of the Biltmore Hotel meeting.

Q. (By Mr. Hall): Now, in the executive committee meeting that the Court referred to, also, there is a reference to spot remover. Spot remover was put out by Schalk Chemical Company [466] in 1947; is that correct? A. As I recall, yes.

Q. Yes. Now, Mr. Smith, I show you Petitioner's Exhibit 33. I ask you if you attended a general sales meeting at the Biltmore Hotel, held on November 26, 27, 28, 29, 30 and December 3, 1945?

A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. Now, on the first page of that exhibit, it states it was decided to market the following products: The first product is plaster pencil, which we have already discussed, and the second product was spot remover, which we have already discussed.

Now, there was a liquid paint brush cleaner?

A. Yes.

Q. Now, did you agree that that product should be produced by Schalk Chemical Company?

A. I believe so; yes, sir.

Q. Did you implement the production, did you start the development of that product, Mr. Smith?

A. No, I don't believe I did.

Q. Now, how about the next one, which is described as all in one household cleaner. Did you agree that Schalk should produce that, market, or Schalk should market that product?

A. Apparently so, from these records here. [467]

Q. Did you do anything to implement that agreement? A. Not that I recall.

Q. And the next item is a varnish remover and that is what we have discussed before; is that correct, the paint and varnish remover? A. Yes.

Q. Which you did nothing to implement?

A. That is right.

\* \* \*

Q. (By Mr. Hall): Mr. Smith, the executive committee, as I recall your testimony, did not solve the situation because of lack of harmony; is that correct? A. I believe so.

Q. That was lack of harmony between you on

(Testimony of Horace O. Smith, Jr.)

the one hand, and Mr. and Mrs. Farman on the other hand; is that correct?      A. Yes.

Q. Mr. Smith, do you recall a meeting between you [468] and your wife, Mr. and Mrs. Marlow, Mr. and Mrs. Baker, in December, 1945?

A. Very vaguely.

Q. Yes. I believe it was on a Sunday and at the home place?      A. It could have been.

Q. Was the tentative arrangement different than the executive committee suggested at that time?

A. I do not recall.

Q. Was it discussed at that meeting that you would have an eight year contract of employment with the company?

A. I don't recall the details, if there were any.

Q. Do you recall that that type of arrangement was ever discussed?      A. I think there was, yes.

Q. And do you recall that the supervision of the trust was proposed to be transferred to your mother?

A. I don't recall those details, frankly.

Q. Now, Mr. Smith, I refer you to Respondent's Exhibit J, which is volume 4 of the minute books of Schalk Chemical Company, and a letter dated December 9, 1946, addressed to you from Mr. Rausch.

Do you recall that letter? That is the letter that is inserted at page 283 of Respondent's Exhibit J.

A. Yes, I recall this letter. [469]

Q. Yes. Well, at the meeting that commences, the minutes of which are on page 283, there, Mr.

(Testimony of Horace O. Smith, Jr.)

Smith, were you in favor of declaring an extraordinary dividend at that time?

A. In line with Mr. Rausch's letter, apparently I was.

Q. Did you recommend it to the board?

A. That I don't know. I haven't read the minutes.

Q. Now, if you will turn to page 284, towards the bottom you will note that it states the secretary thereupon announced that in view of the controversy which had arisen, it seemed best to hold said meeting—meaning the shareholders meeting—on a particular date for the purpose of electing—it says shareholders. I believe it means, it is supposed to be directors.

A. Shareholders.

Q. What controversy was that, Mr. Smith; do you recall?

A. No, I don't.

Q. Well, do you know who was at the meeting at which the extraordinary dividend was declared?

A. Mr. Henry J. Rausch, Mrs. Farman and Mr. Farman, and Mr. Wackerbarth, as I recall.

Q. Was Mr. and Mrs. Marlow also there?

A. I don't recall if they were at that meeting or [470] not.

Q. Was Mr. or Mrs. Baker there?

A. I don't recall that, no. Evidently Mr. Guthrie was there and Mrs. Marlow, Mr. Marlow and Mr. and Mrs. Baker.

Q. Now, that is the first occasion that I have seen in these minutes when the whole family was present, Mr. Smith.

A. Yes.



(Testimony of Horace O. Smith, Jr.)

Q. According to the minutes. Now, why were the family present on that date?

A. That I don't recall.

Q. Was there opposition to the dividend?

A. That I don't recall either.

Q. Is it possible that there was opposition?

A. There could have been, yes.

Q. Do you know of any other reason for the family being present? A. I don't believe I do.

Mr. Hall: Your Honor, may I have Petitioner's Exhibit 16 and Petitioner's Exhibit 22, and I hope I have the right ones this time.

Q. (By Mr. Hall): Mr. Smith, I believe it was your testimony yesterday that you recalled no proposal under which the corporation would pay you any part of the moneys that were [471] eventually paid to you; is that your testimony?

A. I am not sure. I don't recall, Mr. Hall. That was 12 years ago.

Q. Yes. Well, I hand you Petitioner's Exhibit 22, which is a letter dated September 12, 1947, addressed to Guthrie, Darling and Shattuck, attention Mr. Olson. A. Yes.

Q. Does that letter bear your signature?

A. Yes.

Q. Now, referring to the first paragraph, it states, "I have studied the plan proposed by you for a settlement of the controversy between Hazel I. Farman, Evelyn Marlow, Patricia Baker and myself," and would you read the next paragraph to yourself?

(Testimony of Horace O. Smith, Jr.)

Does that refresh your recollection?

A. Yes, it does.

Q. Apparently there was a proposal made that Schalk Chemical Company in some form pay you the money that you eventually got; is that correct?

A. That is correct, I believe.

Q. Now, are you familiar with this letter; have you read a copy of it recently?

A. No, I haven't, no.

Q. Would you read the letter in full, please?

A. Okay. [472]

Q. Now, is your memory refreshed as to the contents of the letter?      A. Yes.

Q. I believe your testimony was yesterday that the \$45,000 that you eventually received was for the purchase of your beneficial interests in the trust; is that correct?      A. Yes.

Q. Now, this letter refers first to the payment of a sum of \$25,000 in cash?      A. Correct.

Q. Is that correct?      A. Correct.

Q. And what was that to be paid for?

A. For, partially for the beneficial interest in the trust.

Q. Well now, I draw your attention, Mr. Smith, to the language commencing at the bottom of page one of the letter, which is Petitioner's Exhibit 22, it says, "in consideration of the foregoing, I am to receive the sum of \$25,000 in cash, certain releases, and a dismissal of the Marlow case."

Now, by the "foregoing," this letter immediately prior to that, you, in the letter state, "I will deliver

(Testimony of Horace O. Smith, Jr.)

to you—" that is to Mr. Olson— "resignations of Mr. Rausch, Mr. Wackerbarth and Mr. Smith, as members of the board of [473] directors of Schalk, and resignation of Smith as supervisor of the trust."

Now, is that what the \$25,000 was for, was that your intent?

A. Not necessarily the intent. The purpose of the \$25,000, as I understood it, was to apply on the purchase of my beneficial interest in the trust.

Q. Well, on page 2 of the letter you state, "in addition to the foregoing, I will grant your clients an option to buy all stock owned by me in the Schalk Chemical Company, on December 29, 1950, at the price of \$2 per share, less any dividends paid thereon between now and said date; said option to expire July 1, 1951."

Now, your beneficial interest in the trust was one-sixth, was it not, Mr. Smith? A. Yes.

Q. And that was an offer from your standpoint to give an option to purchase that one-sixth interest; is that correct? A. Yes.

Q. And that was your offer was it, \$2 a share, or a total of approximately \$32,000, wasn't it, for the stock interest; is that correct? A. Yes.

Q. And that is a total aggregate, the two of them [474] put together of \$57,000; is that correct?

A. Yes.

Q. In this letter, the two matters are completely segregated, are they not?

A. It would appear that way, yes.

(Testimony of Horace O. Smith, Jr.)

Q. And, but for the declaration of trust, you would not have been president necessarily, is that correct, Mr. Smith?

A. I believe that is correct, yes.

Q. And by reason of your being supervisor of the trust, that you held control of the company?

A. That is right.

Q. And this letter states, does it not, that you would give up that control for \$25,000 in cash?

A. Yes, it does state that.

Q. I hand you Petitioner's Exhibit 16. Are you familiar with that agreement of January 15, 1948, Mr. Smith?

A. Yes, I am familiar with it.

Q. Have you read that agreement thoroughly, or are you familiar with it?

A. I haven't read it for some time.

Q. Did you read it at the time you signed it?

A. Yes.

Q. Did you understand the terms of it at that time? A. Yes. [475]

Q. Now, under this agreement, you were paid \$25,000 on January 15, 1948; is that correct?

A. That is correct, yes.

Q. Mr. Smith, I refer you to page 5 of Petitioner's Exhibit 16, and the language on page 5 that states:

“In the event that second parties, second parties being the family, their heirs, successors, or assigns shall fail, neglect or refuse to pay the balance of the purchase price as herein provided, the first parties

(Testimony of Horace O. Smith, Jr.)

shall be released—"first parties being yourself—" shall be released from any and all obligation to sell, transfer, convey, or assign the property herein described, and second parties, their heirs, successors and assigns, shall be released of any and all obligations to purchase said property, or to pay to first party any additional moneys hereunder."

Did you understand that paragraph?

A. Yes, I did.

Q. What does it mean?

A. Simply that if they refused to, should refuse to pay the balance of \$20,000, they would be, the second parties would be——

Q. Released, isn't that correct?

A. Released from any obligation.

Q. In other words, they did not have to pay the \$20,000; [476] is that correct?

A. That is correct.

Q. Were you concerned whether they would?

A. To some extent, yes.

Q. Well, to what extent, Mr. Smith?

A. To this extent, that I wanted to get the full moneys that were agreed upon out and be free of any connection with the corporation.

Q. Well, if they had not paid you the \$20,000, then you would have remained the stockholder; is that correct?      A. Yes.

Q. And you would have retained the \$25,000?

A. Yes.

Q. Yes. Now, was not the \$25,000 then to get you out of control, the same as you expressed in

(Testimony of Horace O. Smith, Jr.)

your letter?           A. It could have been, yes.

Q. Now, referring to the same page——

A. Matter of interpretation.

Q. Page 5 of Petitioner's Exhibit 5, it states specifically "this agreement may be assigned by second parties, their heirs, successors, and assigns, at any time during the term hereof."

Did you understand that provision; do you know why that provision was inserted? [477]

A. That in the event of death of my mother or either one of my sisters, they could assign their rights to this document to them.

Q. Was not that provision put in there, Mr. Smith, so that it could be assigned to the corporation?           A. That I don't know, Mr. Hall.

Q. Would you say it was not discussed?

A. Not to my knowledge.

Q. Now, I believe you stated that you received a certified check for the \$25,000.

A. That is my recollection.

Q. Do you recall the circumstances of why that was a certified check? It was a check on the law firm of Guthrie, Darling and Shattuck, was it not?

A. That I don't recall.

Q. You don't recall the circumstances?

A. No. It could have been on the law firm of Guthrie, Darling and Shattauck.

Q. Did you require that the check be certified?

A. Not as I remember.

Q. Not as you remember. Now, with regard to these two exhibits again, that is Petitioner's Exhibit

(Testimony of Horace O. Smith, Jr.)

22 and Petitioner's Exhibit 16, who advised you to have the moneys lumped in one figure, rather than separately as stated in Petitioner's Exhibit [478] 22?

A. I believe it was Mr. Wackerbarth.

Q. What was his advice, Mr. Smith?

A. His advice was that since I had only a beneficial interest in the trust, I had no legal right to sell or assign my stock, which was held by the trust.

Q. Were the figures put together into one aggregate figure for your personal tax reasons?

A. Not necessarily.

Q. Was that part of the advice?

A. That I don't recall.

Q. You have no recollection on that?

A. I don't recall the details.

Q. I understand you reported the \$25,000 and the ultimate \$20,000 as a capital asset sale transaction; is that correct?

A. Yes, yes.

Mr. Hall: No further questions at this time.

Mr. Gardner: Just two or three questions, Mr. Smith.

### Redirect Examination

By Mr. Gardner:

Q. Referring to Exhibit 22, in which you apparently send a proposal to Mr. Olson, the figures set out in that exhibit are \$25,000 and \$20,000, or in some such breakdown; are they not?

A. Yes. [479]

(Testimony of Horace O. Smith, Jr.)

Q. What is the breakdown? A. 25 and 20.

Q. 25 and 20. Now, in your mind, that is your own mind——

A. Pardon. Correct. \$2 a share for it, less any dividend paid for my stock in the trust.

Q. Now, in your mind, when you sent that proposal, did you—would you state whether or not it was your intention to contain the entire amount in return for your entire beneficial interest in the trust? A. That was my understanding.

Q. The breakdown was merely to make it clearer; is that right?

A. And to make it possible for them to enter into this agreement.

Mr. Gardner: No further questions.

Mr. Hall: May I have that, Mr. Gardner.

#### Recross-Examination

By Mr. Hall:

Q. But the intent that you have just stated, Mr. Smith, is directly opposite to what is set forth in this letter, is it not? A. No, I don't believe so.

Q. Well now, I point out again that in consideration of certain things you were to receive \$25,000. [480]

A. Yes, on the payment of that I was naturally compelled to offer them my resignation, together with the resignation of Mr. Wackerbarth.

\* \* \*

Mr. Gardner: Call Mr. Wackerbarth. [481]



HENRY O. WACKERBARTH

a witness called by and in behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Mr. Hall: May Mr. Farman be excused, if he wishes to go?

Mr. Gardner: I have no further questions of him.

The Court: He may.

The Clerk: Be seated, please.

Would you state your name and address for the record, sir?

The Witness: Henry O. Wackerbarth. 326 West Third, Los Angeles, California. That is my office address.

Direct Examination

By Mr. Gardner:

Q. Mr. Wackerbarth, what is your occupation, sir?      A. I am an attorney.

Q. How long have you been an attorney?

A. Since 1913.

Q. Since 1913?      A. Yes.

Q. Do you know, or did you know Mr. Colyear?

A. Yes, sir.

Q. Would you state what your relationship was with Mr. Colyear, and when you first met him, sir?

A. My relationship with Mr. Colyear was as his attorney. [482] I met him many, many years before 1913. The Colyear family and our family were friends many years back before that.

(Testimony of Henry O. Wackerbarth.)

Q. I see, sir. How long did you represent Mr. Colyear as an attorney?

A. Since 1913, up to the date of his death, August 11, 1943.

Q. And during that time, did you have any occasion to represent Mr. Colyear in connection with the Schalk Chemical Company?      A. I did.

Q. Would you state, sir, your first relationship with that company?

A. With the company would be when I became secretary of the company.

Q. When was that, sir?

A. It must have been 1931, the exact date I cannot say.

Q. 1931?      A. I think that is 1931.

Q. Were you instrumental in drawing up a trust arrangement providing for the control of that company?

A. I did not draw the trust. Frank Thomas, who was the attorney for Frank McGinnis, drew the trust.

Q. I see. But then you became associated with the company [483] as a secretary, did you say?

A. As the secretary of the company when Mr. Colyear went in control of it.

Q. When he took over as supervisor of the trust?

A. That is right. I went in as secretary at that time.

Q. You went in as secretary at that time?

A. Yes, sir.

(Testimony of Henry O. Wackerbarth.)

Q. And how long did you remain as secretary of Schalk Chemical Company?

A. Until 1948, I think the minutes are, when the agreement was entered into, which has been referred to here as, I think, January 15, 1948, that was about the time that I—

Q. I see. Now, during the early years, that is 1931 up to say 1942, as secretary of Schalk, did you discuss the corporate business with Mr. Colyear?

A. Oh, yes, many times.

Q. Many times?

A. Oh, yes. We held the meetings at my office.

Q. Now, during the period say 1931 to 1935, did you have any discussions with Mr. Colyear, as secretary of the corporation, regarding the possible employment of Mr. Farman?      A. I did.

Q. And what was the result of those discussions, sir? [484]

A. Mr. Colyear stated to me that he would not under any circumstances permit Mr. Farman to come into the company.

Q. What was his reason, sir?

Mr. Hall: I object, your Honor, on the ground that it is hearsay, the reasons of Mr. Colyear, unfortunately he is deceased, and I do not have the opportunity to cross-examine him on his opinion as to Mr. Farman.

The Court: Sustained.

Mr. Gardner: If the Court please, this is—he is speaking now in his corporate capacity, rather than any individual. This is the result of the corporate

(Testimony of Henry O. Wackerbarth.)

discussion regarding the employment of Mr. Farman.

A corporation is represented by its officers and they are now talking; I think it takes it out of the realm of hearsay, your Honor.

The Court: I will adhere to my ruling.

Mr. Gardner: All right.

Q. (By Mr. Gardner): Do you know whether or not Mr. Farman attempted to gain employment with the corporation during the period 1931 to '36, sir?

Mr. Hall: Of your own knowledge.

The Witness: Only the discussions in which Mrs. Farman had stated that she wanted him in the company, [485] brought into the company. That was all that I heard, and that was at meetings of the shareholders there, and that was early in the history of Mr. Colyear's management of the company.

Mr. Gardner: I see, sir.

Q. (By Mr. Gardner): Were subsequent requests made to put Mr. Farman into the company, do you know?

A. Well, no. I think the matter was dropped, because Mr. Colyear to do it, refused to permit him to come into the company. It was then dropped and that was the time that a breach then developed between Mrs. Farman and Mrs. Smith, at that time, and Mr. Colyear, because he wouldn't bring her into the company.

Up to that point of time, Mr. Colyear had been a very loyal friend of hers, apparently on both sides, because at their request he had been appointed

(Testimony of Henry O. Wackerbarth.)

guardian of the children in place of Mr. Frank McGinnis. There was a very close tie-up at the time that Mr. Colyear refused to bring Mr. Farman into the business.

Q. From that time there was a breach?

A. That is correct.

Q. Personal breach. Now, let's go on up to the year 1946, sir, during the year 1946, Mr. Horace O. Smith, Jr., was the president of Schalk and the supervisor under the trust; is that correct, sir? [486]

A. That is correct.

Q. Now, can you state whether or not there were repeated efforts in 1946 to have Mr. Smith, Jr., removed as president and as supervisor by the other stockholders?

A. Yes. The answer is yes.

Q. There were repeated efforts; is that correct, sir?

A. Yes, sir, more than, I would say more than efforts. There were requests that he step out.

Q. Now, of your own knowledge, do you know whether these requests started prior to 1946?

A. Yes, they did.

Q. Did they start prior to 1945?

A. Well, I would say they started in 1945. That would be my first recollection of them. It was before these actions were taken in 1946. Yes. It had been going on for some time; they wanted him out.

Q. They wanted him out?

A. Yes. When I say they, I am referring to Mrs Farman primarily.

Q. And who did the talking for Mrs. Farman?

(Testimony of Henry O. Wackerbarth.)

A. Well, Stanley Guthrie was her attorney.

Q. I see. A. Yes.

Q. And was she also represented in part by Mr. [487] Farman?

A. I didn't hear that.

Q. Was she also represented in part by Mr. Farman?

A. Mr. Farman didn't come into the picture until about the time that he was, he went on the board. Up to that point of time, I don't think Mr. Farman attended a board meeting, and if you want the date for that, I will give it to you.

Q. It is not too important that we have that date, Mr. Wackerbarth. It was in 1945, I believe, September.

Now, to go back again, for just two questions regarding Mr. Colyear, what other interests did Mr. Colyear have that you knew of, Mr. Wackerbarth?

A. Mr. Colyear founded the Colyear Motor Sales Company prior to 1912. Up to 1912 his business was the sale of motor trucks and automobiles.

In 1912, or '13, probably '13, they changed their business, got away from the sale of automobiles, and motor trucks, and went into the parts business, automotive parts. He also had a warehouse here, warehouse business, operated the Colyear Van and Storage Company, and he also had a furniture store on Main Street.

That besides other, quite a few pieces of real property, which he owned here and looked after.

(Testimony of Henry O. Wackerbarth.)

Q. Do you know Mr. Colyear's reputation as a businessman, [488] sir?

A. Well, he was always considered to be a very able and astute businessman.

Q. Now, you handled the affairs of many businessmen, don't you, sir, as an attorney?

A. Quite a few, yes.

Q. In your opinion, where do you place Mr. Colyear?

A. Mr. Colyear was one of the ablest businessmen that I ever met.

Q. Now, when young Mr. Smith came to work for the corporation in 1936, do you know whether or not Mr. Colyear and Mr. Lieben were considering grooming him for the presidency of the company some day?

A. That was the purpose in bringing him into the business, yes, so that he could take over at the time that Mr. Colyear stepped out.

Q. And it was their purpose to train him for that job; is that correct?

A. That is correct; that is correct. That is the reason he brought him into the business while he was still alive.

Q. Referring to Exhibit J, minutes of the corporation of Schalk Company, board of directors for June 24, 1942, would you state whether or not, sir, you are the one that prepared those minutes? [489]

A. I did, I wrote the minutes.

Q. And——

(Testimony of Henry O. Wackerbarth.)

A. Signed them and Mr. Colyear signed them also, as president.

Q. Now, these start at page 230 of Exhibit J, don't they?      A. That is correct.

Q. And going over to the middle of the page, 231, sir, just past the middle,—wait a minute, I have the wrong page here.

I intended to refer to the minutes for the date September 1, 1942, a meeting of the board of directors of Schalk Company, page 233 of Exhibit J, going to page 235, approximately the middle of the page.

It is stated there that the chairman thereupon reported that he felt Horace O. Smith, Jr., had had sufficient training in the business of the Schalk Chemical Company to assume chart of the business, and the presidency of the corporation, and that he, Mr. Colyear, desired to resign as president, but to retain his position as one of the directors of the company, as well as the supervisor. Horace O. Smith, with the Union Bank.

Do you recall writing that, sir?      A. Yes, sir.

Q. And the chairman who made that statement [490] was Mr. Colyear; is that correct?

A. That is correct.

Q. Do you consider Mr. Colyear, I mean, from your association with him, and from your association with other businessmen, as a man of keen business ability and one who would certainly know whether or not a person had had sufficient training?



(Testimony of Henry O. Wackerbarth.)

A. Yes. Mr. Colyear employed hundreds of people in his various businesses.

Q. Now, at that time, was it also your opinion or would you state whether or not it was your opinion that Mr. Smith was ready to take over as president of Schalk?

A. I would say that Mr. Smith was ready to take over as president of the Schalk Chemical Company under Mr. Colyear's supervision, and in association with Mr. Lieben, I would say yes.

Q. Well, now, Mr. Lieben, what sort of a person was Mr. Lieben, sir?

A. Mr. Lieben was a very able businessman, and had been with the Schalk Chemical Company over 20 years at that time.

Q. Now, would it be your recommendation that Mr. Smith, Jr., if he took, when he took over the company, and when he did take over the company, listen [491] and work closely with Mr. Lieben?

A. Yes. It was understood that he would and I would say that he did.

Q. And that was the desire of Mr. Colyear, too, wasn't it?

A. That is correct.

Q. Mr. Wackerbarth, I want to refer you to page 283 of Exhibit J, minutes of the board of directors of Schalk Chemical Company for the 27th day of December 1946. Would you examine those minutes, sir, and see if that is your signature?

A. That is my signature, yes.

Q. Did you prepare those minutes?

A. I did.

(Testimony of Henry O. Wackerbarth.)

Q. Would you refer to the bottom of page 283, and state for the record that last sentence on that page 283 of Exhibit J?      A. I have read it.

Q. Would you read it aloud, sir?

A. "After considerable discussion with reference to the amount of dividend to be declared, director G. I. Farman presented the following resolution, and moved its adoption."

Q. That relates to what, sir?

A. A resolution for a dividend in the sum of \$42,000.

Q. Now, do you recall now whether or not Mr. Farman [492] made——

A. Mr. Farman made that motion.

Q. Now, sir, going to the agreement, that is the agreement of January, 1948, whereby Horace O. Smith, Jr., steps out as supervisor, would you state, sir, when approximately the preliminary negotiations resulting in that agreement began?

A. They began the date—I would have to get from, from the file of Marlow versus Union Bank to get the exact date. But the occasion was the sustaining of the demurrer which I interposed to the complaint to remove, to set aside the trust and remove the supervisor and Mr. Smith.

After the Court has sustained that demurrer, then the matter of discussion of settling this matter was presented.

Let me put it this way, it was presented in earnest; there had been discussions before that about Bob getting out.

(Testimony of Henry O. Wackerbarth.)

Q. In fact, that, did that continue all during the year 1946, or do you recall?

A. Well, I wouldn't want to pinpoint as to any time. It is a matter that had been going on for a considerable period of time.

Q. Now, how many causes of action were in this complaint to remove—— [493]

Mr. Hall: I object to that question, your Honor, on the grounds that it is immaterial. The complaint is in evidence.

The Court: The complaint is in evidence.

Mr. Gardner: I realize it is, your Honor. I would like to bring out the fact that——

The Court: You may show it to the witness, if you wish.

Mr. Gardner: He might recall it.

Q. (By Mr. Gardner): Do you recall?

A. Well, I don't recall. There was probably a dozen somewheres around that. There was probably around 10, 12 or more.

Q. And your demurrer as to each one of these was sustained; is that correct?

A. That is correct; that is correct.

Q. Now then, from that point on, you began to negotiate in earnest, as you might say, for some settlement of this problem? A. That is right.

Q. You represented Mr. Smith, Jr., in these negotiations?

A. That is correct; that is correct.

Q. And could you state whether or not there was ever [494] considered during these negotiations now

(Testimony of Henry O. Wackerbarth.)

resulting in the final agreement of January, 1948, was there ever any consideration made as to, that Horace Smith, Jr., might purchase the interests of the other stockholders; do you recall that?

A. I don't recall any discussion of Horace Smith ever purchasing the interest of the others.

Q. I see. Now, as to the discussions relating to Horace Smith selling his beneficial interest in the trust, do you recall whether or not there were any discussions that the corporation purchase Mr. Smith, Jr.'s beneficial interest in the trust?

A. There was a matter presented, but so far as our position was concerned, we didn't consider it. That is, we didn't consider that we would enter into any such agreement for the corporation to purchase Horace Smith's interest in that trust.

Q. What was the reason, sir?

A. Well, primarily that it wasn't a matter that the corporation was interested in, and Horace Smith controlled the board of directors, and he couldn't very well sell his interest in a non-assignable trust to the corporation for a sum of money, and ask the vote and approval of the directors that he controlled, because he did control three directors. For that [495] reason, we wouldn't consider any sale to the corporation, of the corporation.

Q. Now, the last document in evidence, 37, please, your Honor.

I show you Exhibit 37, sir, and ask whether or not you recall receiving that from the representatives of the family?

(Testimony of Henry O. Wackerbarth.)

A. I don't recall. I have no copy of this, let's put it that way, and if you will permit me to read it first. I don't recall.

Q. Yes, surely, read it.           A. I have read it.

Q. Do you recall receiving that document from Mr. Olson?

A. I don't recall receiving it, no. That is, at this time I don't recall receiving it.

Q. Do you recall whether or not there was a discussion along those lines, sir?

A. My recollection that there was something said about the corporation purchasing, but we would not consider that at all.

Q. Therefore, the discussion that you had relating to whether or not the corporation would purchase it was very brief?           A. Was dropped, yes.

Q. And from that time on, the question of the sale [496] of Mr. Smith's beneficial interest in the trust was strictly between whom?

A. Between Mr. Smith on one side, and the family on the other. The family being Mrs. Farman, primarily, and the daughters, the two girls both seemed to be working with their mother, so that we assumed it was with them, too.

Q. Now, during these negotiations, how many would you say you had, sir, from the time that the demurrers were sustained in the prior suit, and the time the agreement was finally executed in January of '48?

A. Well, there were very few. I don't remember

(Testimony of Henry O. Wackerbarth.)

how many, but there were very few conferences that we had in connection with it.

Q. Now, were these conferences attended by the members of the family; that is, Mr. Farman, Mrs. Farman?

A. No. Mr. Guthrie was the one that I discussed it with.

Q. You did not discuss it with the members of the family?

A. I don't think—I am not, I am sure I didn't discuss it with Mr. Farman, and I don't think Mrs. Farman ever entered into the negotiations. They were primarily with Mr. Guthrie.

Q. I see, sir. In your conversations with Mr. Guthrie, you were talking solely about the members of [497] the family acquiring beneficial interest of Horace O. Smith, Jr., in the trust; is that correct?

A. That is correct.

Mr. Gardner: Exhibit 16, please.

Q. (By Mr. Gardner): Mr. Wackerbarth, I hand you Exhibit 16, and ask if you have seen that document before, or a document similar to that?

A. I saw this document at the time it was signed, signed over in Mr. Guthrie's office.

Q. You were present at that time, sir?

A. Yes.

Q. Is this the document that you, or did you prepare the document?      A. I did not, no.

Q. Did you assist in the preparation of it?

A. No. Mr. Guthrie prepared it. That is, I pre-

(Testimony of Henry O. Wackerbarth.)

sumed he prepared it. It was presented to us at a meeting over at his office.

Q. Now, was this document in accordance with certain agreements that you had made with Mr. Guthrie in an effort to settle this dispute?

A. This was to carry out the discussion which Mr. Guthrie and I had had about how the matter could be settled. [498]

Q. And actually, you are talking about the physical preparation was not done by you?

A. No, I did not, no.

Q. But the content of the agreement you assisted in that?

A. I discussed it with him, as to what Horace Smith was willing to do.

Q. I see. Now, relating to the amounts set forth in there, that is \$25,000 to be paid as of this date, that is the date the agreement was executed, and the \$20,000 to be paid at a subsequent date after the trust expired, what was your understanding as to the purpose of the payment of the total sum of \$45,000, sir; what were the purchasers getting?

A. They were, Horace Smith was to step out of the corporation, completely out of the corporation. He was to step out as supervisor of the trust, as president of the company, as an employee of the company, and he was to give up his interest under the trust. The trust was a non-assignable trust, and he couldn't assign his interest in it.

Therefore, he could only transfer his interest if, as and when a trust terminated.

(Testimony of Henry O. Wackerbarth.)

Q. Now, you were familiar with the business at that time, were you not, Mr. Wackerbarth?

A. Yes. I was secretary of the corporation for many [499] years. I didn't go down to the plant, if that is what you mean. I have been there a few times, but I didn't go down there and take any part in that.

Q. No. I am sure you didn't. But you were present at all the board meetings, were you not, sir?

A. I was.

Q. And you did take an active part in the meetings?

A. And the discussions, yes. I was a director there for a number of years.

Q. So, you knew very well the business trend and so forth in relation to that corporation?

A. Yes, I would say I did.

Q. Now, at the time that Mr. Smith, Jr., executed that agreement in January of 1948, what would you say the value of the corporation, Schalk, itself, what was the value of the stock at that time, sir?

Mr. Hall: Objected to, your Honor, on the ground of this witness has not been qualified to state an opinion on that subject.

The Court: Sustained.

Q. (By Mr. Gardner:) Were you familiar, sir, with the assets, liabilities and possibilities of this company?

A. Well, I was familiar with the assets and liabilities, and familiar with what the corporation



(Testimony of Henry O. Wackerbarth.)

had [500] been doing since I was secretary, in the way of sales and profits.

Q. Were you familiar with whether or not the corporation had an extensive good will throughout the country?      A. The corporation——

Mr. Hall: That is objected to on the ground it calls for the conclusion of the witness.

The Court: He may answer.

The Witness: The corporation had done a considerable amount of advertising over a long period of years, and it was the concensus of the directors there that they had established a good will for their products, an extensive good will for the products.

Q. (By Mr. Gardner): Do you know whether or not this good will was shown on the books of the corporation?

A. I don't think that it reflected anything on the books, as I recall.

Q. And actually, it was one of the most valuable assets they had, wasn't it?

A. I would—well, of course, their products were valuable assets, but I would say that the fact that they had done this tremendous amount of advertising, was certainly an asset of the business. [501]

\* \* \*

Q. Well, Mr. Wackerbarth, do you have any idea, state whether or not you have any idea as to the possible price that could be obtained from the sale of all of the stock of Schalk as of January, 1948, sir.

A. No, I wouldn't want to say. I had never had

(Testimony of Henry O. Wackerbarth.)

taken any part whatsoever in trying to dispose of the assets of the business. I had heard discussions, if that——

Q. No, I don't want that. A. Sir?

Q. I wouldn't want that.

A. That is all I could say, that I know, sir, discussions that I had heard about it.

Q. I see. Referring once again to page 283 of Exhibit J, and the meeting of December 27, 1946, it appears that there were a great many people present at that meeting, sir.

A. Stanley Guthrie was there, as attorney for Mrs. Farman; and Mr. Farman, Evelyn Marlow, and Fred W. Marlow, her husband were there; Patricia Baker and J. C. Baker, her husband, was there, and Henry Rausch was present at the meeting. [502]

Q. Now, do you know whether or not there was any disagreement as to the \$42,000 dividend stated in those minutes?

A. There was no disagreement as to the amount of the dividend; no, sir.

Q. Did Mr. Farman say anything against it?

A. He did not oppose it at all. He made the motion for the payment of the dividend.

Q. And did all of the directors vote in the affirmative, sir? A. They did.

Q. Do you know the purpose or the reason for all of these people being present at this meeting?

A. I can only answer that by what occurred at the meeting, if that helps any.

(Testimony of Henry O. Wackerbarth.)

Q. What did occur?

A. As to why they came, I don't know, but I know what they did.

Q. What did they do, sir?

A. Mr. Farman, Mr. Marlow led off there, and wanted to know why this business was being run under a trust, and I told him that that trust had been entered into many years before. And that up to the present time, I had never heard of any objection to it.

And he said that it was very distasteful to the [503] family and that he didn't know why this business had run under a trust that was so unfair, and distasteful to the family.

And I said that that was a matter that I didn't see any reason of going into it at this time, because it had occurred many years before. And it had occurred as a result of avoiding a long-drawn out lawsuit.

And he said that he was going to go into that matter and that he didn't believe that it was a good trust, that he was going to try and set it aside, upset it.

And that was the—there is a reference here that so far as I know was the only time that Mr. Marlow was ever present at the board of directors meetings.

Q. Thank you, sir. Just one further question regarding the management of Horace Smith, Jr., that is the presidency of Schalk Chemical Company.

From 1942 to 1947, at the time he was disposed

(Testimony of Henry O. Wackerbarth.)

or sold his interest in 1948, what was your opinion, sir, of his tenure as president and as supervisor?

A. The business progressed. It was going along well. They were paying dividends, and making profits, and the only objection was from his mother, and I think his sisters didn't want to run it, but that was the only objection from that end of the family.

Q. In 1947, they didn't make very much money, in [504] fact there, that was a losing year, wasn't it, Mr. Wackerbarth?

A. Yes. That was a year there that one of the questions involved was the matter of advertising, and the purchase of some new equipment, and I believe the expenses of the officers was very heavy that year, as I recall it.

Q. That was in 1947?

A. 1946 and '7, there was considerable expense. They had a very heavy advertising expense that year.

Q. Was that in 1947?                   A. 1947, yes.

Q. Was that a part of the policy to keep its products before the public?

A. Yes. They always maintained a lot of advertising; all they had to sell was some products there, and their competition was always heavy. They had to advertise heavily and that was always a representation which I was given to understand was made to the trade that they would advertise heavily.

Q. Well now, just another point. Going back to

(Testimony of Henry O. Wackerbarth.)

the earlier years, do you know whether or not dividends were declared in almost every year?

A. I think dividends were declared almost every year, if I recall rightly. I would like to see the minutes, but I think you will see——

Q. There was a practice—— [505]

A. There was one year there was a loss, and I think they still paid a dividend that year.

Q. This was what practice——

A. Yes, yes. The family had to live on that.

Q. Yes.           A. Yes.

Q. Did Mrs. Farman state that in the meeting——

Mr. Hall: I object, your Honor. That is not within the knowledge of this witness.

The Witness: It was said there at the meetings, if that was, helps any, that was the only source of income, if that helps any.

The Court: Has the witness—if the witness heard Mrs. Farman so state, he may so testify.

Mr. Hall: He has so testified.

The Witness: Yes, that is correct.

The Court: His testimony will remain in the record.

Mr. Gardner: Did you get his answer?

The Reporter: Yes.

Q. (By Mr. Gardner): During the period, entire period that you were secretary of this corporation, did you notice whether or not the daughters took any part at all in the management as reflected

(Testimony of Henry O. Wackerbarth.)

by attendance at board meetings, and participation therein? [506]

A. Yes. They started coming to the meetings. Well, Mrs. Marlow started coming to the meetings, I think, in 1945 was when she started coming.

If you want to know the first time that she appeared, I think I can tell you.

Mr. Hall: It was in 1936, I believe, Mr. Wackerbarth.

The Witness: Well, if she appeared in 1936, then she didn't come for a long, long period of time after that. She went on the board in 19——

Q. (By Mr. Gardner): Are you referring to a file where you——

A. That is my copies of the minutes.

Q. That is your copy of the minutes?

A. Yes.

The Court: The minutes are in evidence, and they will speak for themselves.

Mr. Hall: That is right.

Mr. Gardner: All right, sir.

Q. (By Mr. Gardner): Now, would you state whether or not the—Evelyn took an active part in the discussions?

A. Yes. She spoke up many times when she was a director. She took an active part in it. She went on April 26, 1944, is when she went on the board.

Q. April 26, 1944, sir? [507]           A. Yes.

Q. And from that time on, did she take an active part, if you remember?

A. Well, she went off at a later time, her stock

(Testimony of Henry O. Wackerbarth.)

was transferred to Mr. Farman, and he went on. She stepped out and Mr. G. I. Farman went on.

Mr. Garner: No further questions.

### Cross-Examination

By Mr. Hall:

Q. Mr. Wackerbarth, how long have you represented Horace O. Smith, Jr., individually?

A. I think the first representation of Horace Smith was when they filed suit against him in 19—April, 1947.

Q. Well, did you—I don't mean to ask an unfair question—you represented him, did you not, at the time of the, when the executive committee was set up in 1945?

A. No, I was representing, I was secretary of the corporation, representing all of them. I wasn't representing him in particular. Horace Smith did ask me questions from time to time.

Q. Did you ever write a letter to Mr. Guthrie and set out the terms of the settlement at that time by implementation of an executive committee? You have no recollection on that, Mr. [508] Wackerbarth?

A. As to whether or not I wrote a letter to Stanley Guthrie?

Q. Yes, concerning the settlement or proposed settlement, at that time, between Mr. Smith and the rest of the family?

A. I could have. I want to look through my file and see if I have one.

(Testimony of Henry O. Wackerbarth.)

Q. No?           A. No, but I could; yes.

Q. We have it here in evidence.

A. All right.

Q. Petitioner's Exhibit 15. I just want to recall it to the witness.

This is the letter I refer to. It is Petitioner's Exhibit 15, and it concerns the settlement under which the executive committee was to be set up.

Now, you were representing Mr. Smith individually at that time, were you not?

A. Well, Horace Smith did talk to me. There is no question about that. The first time that I ever represented him in any litigation, when they set aside the trust, but he did turn to me, if that is what you mean.

Q. I am speaking of the dispute between the family members and the negotiations, and attempts to settle that dispute. Did you represent Mr. Horace O. Smith, Jr., [509] individually throughout those negotiations?

A. He discussed this matter with me. I was never employed by Horace O. Smith; no, the answer is no on that. He did discuss those matters with me from time to time; that is correct.

Q. Now, at whose request was Mr. Smith employed by Schalk Chemical Company?

A. At whose request?

Q. Yes.           A. Mr. Colyear.

Q. And who requested Mr. Colyear to employ Mr. Smith?

A. My recollection is that his mother wanted him



(Testimony of Henry O. Wackerbarth.)

in the business. That is early in the inception, and Mr. Colyear held off for a long time in bringing him into the business.

Q. But there was insistence by Mrs. Farman?

A. That he be brought into the business.

Q. Yes.

A. That is the way I recall it, that she wanted him in the business.

Q. Now, regarding this, your discussion with Mr. Colyear concerning possible employment of Mr. Farman, I believe it was some time in the years 1931 to 1935; were the discussions, or requests that Mr. Colyear had, did they emanate from Mrs. [510] Farman? A. That is correct.

Q. Did Mr. Colyear to your knowledge, or did you at any time discuss it with Mr. Farman?

A. No.

Q. Did Mr. Farman make a request for employment?

A. Not to me and I never heard him make one.

Q. Those were all requests made by Mrs. Farman? A. That is correct.

Q. Mr. Wackerbarth, referring to Petitioner's Exhibit 16—— A. Yes, sir.

Q. ——which is the settlement here——

A. Yes, sir.

Q. ——how much of the total amount of \$45,000 was for Mr. Smith's one-sixth of the stock interest?

A. There was no break-down to the best of my knowledge, because there was a clause which I insisted be put in there, and that reads as follows:

(Testimony of Henry O. Wackerbarth.)

“The entire purchase price of the property herein agreed to be sold by the first party to the second party, shall be the sum of \$45,000, less any distributions made by first party from said trust as herein provided; and the sum of \$25,000 paid by second parties, as a consideration to first party for entering into this agreement shall, in the event second parties, their heirs, successors, or [511] assigns, comply actually and promptly with all the terms and conditions thereof be applied toward the said purchase price.”

Q. All right. Now, reading, if you will, look at the last part of that paragraph that you read, Mr. Wackerbarth.           A. Yes, sir.

Q. It says that the sum of \$25,000 shall apply on the \$45,000 if the second parties comply with this agreement; is that correct?

A. That is what it says.

Q. What is your understanding, supposing the second parties had not paid the \$20,000 in escrow in 1951, is it your understanding that by reason of this paragraph that the obligation to pay the \$20,000 would be enforceable?

A. No, I don't, no. My recollection of this, I said I haven't seen this since the day in Mr. Stanley Guthrie's office up till today, but my recollection is that they could default on that \$20,000.

Q. In other words——

A. Bob would then own it, would then own his stock.

Q. Then he would own his stock?

(Testimony of Henry O. Wackerbarth.)

A. That is correct.

Q. Isn't the \$20,000, was payable for the stock?

A. No, no, no. It was a lump sum of \$45,000, was [512] the amount which they were to pay for him stepping out of the picture, and giving up his stock.

Q. All right. But breaking it down, they didn't have to pay the \$20,000 and they did not have to pay, acquire his stock interest; is that correct?

A. I think that is correct. If you will give me an opportunity, I will look at this, though, and—but that is my recollection of it.

Q. Take an opportunity.

A. All right.

Well, are you ready for me?

Q. Yes.

A. You have a clause here on page 2 that provides that on or before 30 days before the termination, that they will pay the \$20,000.

Then you have another clause in here that in the event that they don't pay that amount of money—

Q. They are released?

A. Well, wait a minute. It says that that, if, they said escrow conditions shall provide that if the second parties or their assigns fail, neglect or refuse to deposit that money within the time and subject to the conditions herein contained, the balance remaining of the aforesaid purchase price then all property and documents deposited by the first party in said escrow shall immediately [513] be returned to him.

(Testimony of Henry O. Wackerbarth.)

That was a provision with reference to escrow instructions.

Then you have got another clause here which says in the event the second parties, their heirs——

Q. We have read that into the record before.

A. Well, I haven't, but that is the one I am referring to.

Q. If they don't pay it, the second parties then they are released of any obligation to pay it; that is the \$20,000, is that correct?

A. Well, I think you have got to read something else into that in order to say that they shall be released.

Q. But you stated before, Mr. Wackerbarth, that they did not have to pay the \$20,000, that was my recollection.

A. Now, you have asked me, and I, I have told you, I want to look at the agreement, you have this clause here in the agreement, "In the event the second parties shall fail, neglect or refuse to pay the balance of the purchase price, the first parties shall be released of all obligation to sell."

Q. Yes.

A. And the second parties, and their successors, and assigns, shall be released from any and all obligations to purchase.

I think that under that agreement it would [514] be my understanding that Bob would have to take an affirmative position there and repudiate the agreement, and they would be released. That is the way, it looks to me.

(Testimony of Henry O. Wackerbarth.)

Q. But they would retain, Bob Smith would retain the \$25,000?

A. Oh, yes, that is correct.

Q. Now, what was the \$25,000 for?

A. That was a down payment.

Q. I hand you Petitioner's Exhibit 22, which is a letter dated September 12, 1947, addressed to Guthrie, Darling and Shattuck, attention Mr. Olson, and signed by Mr. Smith. It is on your letterhead. Are you familiar with that letter?

A. I want to look at it first.

Yes, I have read that letter.

Q. Did you dictate that letter, Mr. Wackerbarth?

A. Well, I would say that I did, yes.

Q. Now, that letter—

A. It was dictated at my office and—go ahead.

Q. Now, that letter clearly segregates the \$25,000 and an amount to be paid for the stock; does it not?

A. That is what it says in this, yes.

Q. Now, that letter is dated September 12, 1947?

A. That is correct.

Q. It refers to a plan apparently that was proposed [515] prior to that time by Mr. Olson, and it also refers to an offer which was heretofore conveyed from your side.

A. Well, that was, that was signed by Mr. Smith.

Q. Yes.

A. And apparently he had conveyed that offer and this was a letter which the offer was—to confirm this offer.

(Testimony of Henry O. Wackerbarth.)

Q. You had conferences with Mr. Olson prior to that date, did you not?

A. I don't think I had conferences with Mr. Olson. I think that most of mine were with Mr. Guthrie. Apparently Bob Smith had these conferences with Mr. Olson, because this was a letter here which it shows that he dictated, but I am sure it was dictated in my office, because it was dictated to my secretary, and I am pretty certain I was present.

Q. Well, would Mr. Smith have met with Mr. Olson out of your presence, Mr. Wackerbarth?

A. He could have.

Q. Did he?      A. I don't know; I don't know.

Q. Would that be customary, Mr. Wackerbarth?

A. It isn't customary, no. But I don't recall Mr. Olson—most of all these dealings were with Mr. Guthrie, but Mr. Olson handled the litigation, that was very definite. [516]

Q. And he participated in some of the meetings, did he?

A. He could have. I don't recall him being in any meetings, but he could have.

Q. Now, is it your testimony that Mr. Guthrie and Mr. Olson did not propose that the money be paid by the corporation to Mr. Smith?

A. Is it my testimony that they did not propose that?

Q. Yes.      A. No. That is not my testimony.

Q. That was their proposition?

A. That was their proposition.

Q. And that was over many months of this negotiation, was it not, their proposition?

(Testimony of Henry O. Wackerbarth.)

A. How long I can't say, but it was never accepted, if that means anything.

Q. Sure. In other words, from your side of the picture, and Mr. Smith's side of the picture, you were insisting that it be between the family members? A. That is correct.

Q. Is that correct? A. That is correct.

Q. And on Mr. Guthrie's side, and the family's side, they were trying to work it out so that the corporation [517] would pay the money to Smith, rather than the individuals?

A. That is correct.

Q. Referring to Respondent's Exhibit J, page 283, the page to which Mr. Gardner referred you to, the meeting at which the extraordinary dividend of \$42,000 was declared. A. Yes, sir.

Q. Do you have a recollection, independent of these minutes, Mr. Wackerbarth, that Mr. Farman made the motion to declare the dividend?

A. I wouldn't say that I had any independent recollection, but I do know that those minutes having been written up by me, they were, that was the way it occurred, and if we look at the minutes following that—wait a minute, here.

Q. May I assist you, Mr. Wackerbarth. Here it is, right here, page 289.

A. That was, there was a shareholders meeting that intervened. Then there was another meeting here, which was adjourned. And there is this notation in the minutes, part of the minutes of the meeting of February 19, 1947.

(Testimony of Henry O. Wackerbarth.)

“The president then called the meeting to order, and thereupon the minutes of the meeting held on December 27, 1946, were read. The president thereupon asked if there were any errors or omissions in said minutes, and director [518] G. I. Farman said he wanted to add to the minutes the statement to the effect that the resolution for the payment of a dividend in the sum of \$42,000 was offered by him on the recommendation of Mr. Rausch, and that the sum of \$42,000 was arrived at as being 70 per cent of the \$60,000 net earnings of the corporation.

“Subject to the correction above referred to, said minutes were approved as read.”

That took place at that meeting.

Q. Well, did Mr. Farman make the motion according to your recollection only, because Mr. Rausch recommended it?

A. I don't know what was in his mind, but he made the motion at the meeting of December 27.

Q. And you said that at the meeting the amount of the dividend was discussed? A. Oh, yes.

Q. Yes? A. Certainly.

Q. Was there opposition to the amount of the dividend?

A. By no one that I know of. There is no record there of any opposition to it.

Q. Was there any discussion of the dividend as such? A. As to the amount of it? [519]

Q. Well, anything concerning the dividend?

A. None that I recall. There is nothing in the minutes that I—



(Testimony of Henry O. Wackerbarth.)

Q. Well now, after considerable discussion, with reference to the amount of dividend to be declared—

A. Yes.

Q. That is stated on page 283?

A. That is correct.

Q. What was the considerable discussion?

A. As to how much they should declare, because you have got Mr. Rausch's letter.

Q. Yes.

A. And may I look at that. I haven't seen it since that day.

Q. Yes.

A. That was a surtax question arising there, as to the tax in the event they didn't declare the sufficient amount. Well, that was his recommendation.

Q. Who were the directors at that meeting?

A. At the meeting, when the dividends were declared?

Q. How many directors did the company have at that time?

A. Horace O. Smith, Jr., was present; Hazel I. Farman was present; G. I. Farman was present and myself, and— [520]

Q. That was all of the directors?

A. I would say that is all, because there is no notation here about any directors being absent. However, if you want me to, I will look through the minutes and see.

Q. May I refer you to page 281, which is the matter of the resignation of Mr. Guthrie was presented and not accepted. There was a split vote.

(Testimony of Henry O. Wackerbarth.)

Would you state for the record whether or not Mr. Guthrie's office as director was declared forfeited at that meeting, and for what reason?

A. I would like to look at the minutes, first. I have no independent recollection of that fact.

Q. All right.

A. All right. Now, your question.

Q. Would you repeat it, Mr. Reporter?

(Question read.)

The Witness: I wouldn't say that, no. I would say this, that his resignation was presented, that I made a motion, "Henry Wackerbarth made a motion to accept the resignation, to accept the resignation of Stanley W. Guthrie as director of the Schalk Chemical Company.

"Thereupon, director Hazel Farman and G. I. Farman stated that they would not vote in favor of a motion to accept said resignation." [521]

Q. (By Mr. Hall): Mr. Wackerbarth, please——

A. I will give it to you, "Thereupon, director Wackerbarth withdrew the motion for the reason that the same had not been seconded, and it had become apparent that the same could not be carried."

Q. Yes.

A. And then Mr. Farman made a statement in favor of Mr. Guthrie, which I will read, if you want me to?

Q. No.

A. "Thereupon, the secretary——" that is myself—"called to the attention of the board of direc-

(Testimony of Henry O. Wackerbarth.)

tors that the provision of Section 2, Article I of the bylaws, and stated that under that section, under said section, that the fact that Stanley W. Guthrie ceased to be a shareholder of the corporation caused him to automatically cease to be a director.”

Q. Yes. Now, prior to that meeting, Mr. Smith had designated Mr. Rausch to be the shareholder; is that correct?

A. Well, I will have to look it up and see. I assume if you say that is true, it is true.

Q. It states at the top.

A. “The president further stated that shares had been issued to Henry Rausch.”

Q. This had been done by getting the shares of [522] stock back from Mr. Guthrie?

A. Yes, that is right, him and/or somebody else.

Q. This statement was made at this meeting, and presented for the purpose of electing Mr. Rausch a director, was it not?

A. Yes. That is what the president suggested here; that is correct.

Q. He was not elected a director at that meeting?

A. He was not.

Q. He was not elected a director at the next succeeding meeting?

A. At a later time he was elected a director, if that answers your question, but I will look and see when, if you want me to.

Q. No. As supervisor of the trust, or may I ask you, are you familiar with the declaration of trust that is involved in this proceeding?

(Testimony of Henry O. Wackerbarth.)

A. I glanced at it this morning. I haven't seen it since that lawsuit in 1947, up till this morning. I looked at a copy of it; that is correct.

Q. Do you know, or do you recall what Bob Smith's beneficial interest was in the trust?

A. Twelve and a half per cent, as I recall.

Q. Which was later increased?

A. And it would then have been increased [523] after——

Q. Mrs.——

A. ——Mrs. Charlotte Wood's death, his interest would have been increased; that is correct.

Q. Now, as a one-sixth beneficial owner, he was in control by virtue of being supervisor of the trust; is that correct?      A. At a time, yes.

Q. Well, up till 1948?

A. Not at all times, no, because first Mr. Frank McGinnis was in charge of it, then Mr. Curtis Colyear was in charge of it; then after him Horace O. Smith, Jr., was in charge of it; that is correct.

Q. When he succeeded to the office of supervisor of the trust, that permitted him to absolutely control Schalk Chemical Company?

A. Permitted him to name three directors, which was the control of the board.

Q. And permitted him to vote all the shares?

A. That is correct.

Q. Now——

A. Well, he was—no. As I recall it, the trustee would give him a power of attorney to vote. I think that is the way it was.

(Testimony of Henry O. Wackerbarth.)

Q. Thank you. In your opinion, Mr. Wackerbarth, in the position of supervisor of the trust, was Mr. Smith [524] a trustee for his two sisters and his mother?      A. Well, I think——

Q. In the management of this business?

A. I think anybody acting in that capacity is a trustee for all of the parties that he represents, and he didn't own the stock, all of the interest, so that he certainly was there representing somebody else, and the authority had been conferred upon him to do it by them.

Q. By whom?

A. By all of the parties that entered into the declaration of trust.

Q. Yes, but did the minor children approve it?

A. The guardian, their guardian approved it, yes.

Q. Mr. Colyear?

A. Yes, that is correct, because I took the petition into court for them, for them to court, to approve his entering into the trust on their behalf.

Q. But it still remains that he was acting in a fiduciary capacity when he was supervisor of the trust; isn't that correct?      A. Who?

Q. Mr. Smith.

A. Well, I would say that he, any time a person represents a group, he is acting to their extent; to that extent, he is acting in the trust capacity, yes.

\* \* \*

[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855, 63862

ORDER ENLARGING TIME

For cause, it is

Ordered: That the time for filing the record on review and docketing the petition for review in the United States Court of Appeals for the Ninth Circuit is extended to January 17, 1960.

Dated: Washington, D. C., November 24, 1959.

/s/ J. E. MURDOCK,  
Judge.

Served November 24, 1959.

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[Title of Tax Court and Cause.]

T. C. Dockets Nos. 63853, 63855, 63862

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the documents submitted under this certificate, 1 to 41, inclusive, as called for by the designation, are the original documents of record on file in my office (excepting the original exhibits which are separately certified), and a true copy of the docket entries as they appear in the official docket of my office, in the

cases docketed at the above numbers in which the petitioners in this Court have filed petitions for review.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of November, 1959.

[Seal]      /s/ HOWARD P. LOCKE,  
Clerk of the Court.

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[Endorsed]: No. 16702. United States Court of Appeals for the Ninth Circuit. Schalk Chemical Company, a corporation, Gerald I. Farman, Hazel I. Farman, John Carver Baker and Patricia Baker, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed and Docketed: December 8, 1959.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

In the United States Court of Appeals  
for the Ninth Circuit

No. 16702

SCHALK CHEMICAL COMPANY, a California  
Corporation; GERALD I. FARMAN and  
HAZEL I. FARMAN, JOHN CARVER  
BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

### PETITIONERS STATEMENT OF POINTS

To the Honorable Paul P. O'Brien, Clerk of the  
Above-Entitled Court:

In accordance with Rule 17(6) of the Rules of  
the above-entitled Court, petitioners state that the  
points on which they intend to rely are:

1. The Tax Court erred in holding that Schalk  
Chemical Company was not entitled to deduct the  
sum of \$25,000 which it agreed to pay to Hazel I.  
Farman, Patricia Baker and Evelyn Marlow in re-  
imbursement of the sum of \$25,000 previously paid  
by them to Horace O. Smith, Jr.

2. The Tax Court erred in holding that the \$25,-  
000 was not paid to Horace O. Smith, Jr., by Hazel



I. Farman, Patricia Baker and Evelyn Marlow on behalf of Schalk Chemical Company and for its benefit and the preservation and protection of its business and reputation.

3. The Tax Court erred in holding that Schalk Chemical Company was not morally obligated to reimburse Hazel I. Farman, Patricia Baker and Evelyn Marlow for the \$25,000 paid by them to Horace O. Smith, Jr.

4. The Tax Court erred in failing to hold that the \$25,000 was paid to Horace O. Smith, Jr., by Hazel I. Farman, Patricia Baker and Evelyn Marlow as the majority owners of Schalk Chemical Company on its behalf and for its benefit and the preservation and protection of its business and reputation in order to free the Company from the absolute control which Horace O. Smith, Jr., a minority owner, had and exercised over the Company by virtue of extraordinary trust powers, in failing to hold that the majority owners had reasonable grounds for believing that removal of Horace O. Smith, Jr., and his management was imperative for the preservation and protection of the Company, and in failing to hold that in similar circumstances persons of ordinary prudence would have acted in similar fashion.

5. The Tax Court erred in holding that Schalk Chemical Company was not entitled to deduct in 1950 either as interest or as business expense the amount which it agreed to pay to Hazel I. Farman,

Patricia Baker and Evelyn Marlow as interest to compensate them for interest incurred by them in borrowing the \$25,000 paid to Horace O. Smith, Jr.

6. The Tax Court erred in holding that the payment of \$25,000 made by Schalk Chemical Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow in 1951, constituted a dividend to Hazel I. Farman and Patricia Baker in that year to the extent that they participated in the payment.

7. The Tax Court erred in holding that the payment of \$20,000 made by Schalk Chemical Company to Horace O. Smith, Jr., in 1951, in redemption of his one-sixth stock interest in the Company constituted a distribution essentially equivalent to a dividend to the remaining shareholders of the Company pro rata, including Hazel I. Farman and Patricia Baker.

8. The Tax Court erred in holding that the payment of \$20,000 made by Schalk Chemical Company to Horace O. Smith, Jr., in 1951, in redemption of his one-sixth stock interest in the Company discharged a contractual obligation of the remaining shareholders.

9. The Tax Court erred in holding that Gerald I. Farman and Hazel I. Farman and John Carver Baker and Patricia Baker omitted from their gross income for the year 1951 an amount properly includible therein in excess of 25% of the amount of gross income reported in their returns.

10. The Tax Court erred in failing to hold that the assessment of deficiencies against Gerald I. Farman and Hazel I. Farman and John Carver Baker and Patricia Baker was barred under Section 275(a) of the Internal Revenue Code of 1939.

11. The Tax Court erred in ordering and deciding that, in the case of Schalk Chemical Company, there is a deficiency in income tax for the taxable year 1950 in the amount of \$15,087.22; that, in the case of Gerald I. Farman and Hazel I. Farman, there is a deficiency in income tax for the taxable year 1951 in the amount of \$11,589.98; and that, in the case of John Carver Baker and Patricia Baker, there is a deficiency in income tax for the taxable year 1951 in the amount of \$2,465.86.

12. The Tax Court erred in that its opinion and decisions in this case are contrary to law and are not supported by the evidence of record.

December 14, 1959.

/s/ DONALD KEITH HALL,  
Attorney for Petitioners.

[Endorsed]: Filed December 15, 1959.

[Title of Tax Court and Cause.]

No. 16,702

STIPULATION

It is hereby stipulated by and between the parties herein through their respective counsel that the exhibits admitted in the trial court proceeding in the above-entitled case be considered by the United States Court of Appeals for the Ninth Circuit in their original form as a part of the record herein without the necessity of printing these matters.

/s/ DONALD KEITH HALL,  
Counsel for Petitioner.

/s/ CHARLES K. RICE,  
Assistant Attorney General,  
Counsel for Respondent.

[Endorsed]: Filed January 13, 1960, U.S.C.A.